IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT.

No. 14516.

UNITED STATES OF AMERICA and
ERNEST J. TIBERINO, JR., Special Agent,
Internal Revenue Service,

v.

MAX POWELL and WILLIAM PENN LAUNDRY, INC.,
Appellants.

On Appeal From Judgment of the United States District Court for the Eastern District of Pennsylvania.

APPELLANTS' APPENDIX.

BERNARD G. SEGAL,
FRED L. ROSENBLOOM,
SAMUEL D. SLADE,
Attorneys for Appellants.

SCHNADER, HARRISON, SEGAL
& LEWIS,
1719 Packard Building,
Philadelphia 2, Pennsylvania,
Of Counsel.

International, 711 So. 50th St., Phila. 43, Pa.

TABLE OF CONTENTS OF APPELLANT'S APPENDIX.

APPELLANTS' APPENDIX.

RELEVANT DOCKET ENTRIES.

1. May 29, 1963. Petition to enforce Internal Revenue Service Summons, filed.

2. May 27, 1963. Order of Court fixing June 5, 1963 at 10 a.m. for hearing to show cause, filed. 5-28-63 noted.

3. June 5, 1963. Certified copy of order to show cause returned "on 5-29-63 served" and filed.

   June 5, 1963. Hearing sur order to show cause—order to be entered.

4. June 5, 1963. Order of Court that defendants produce certain documents for inspection, etc., filed. 6-6-63 noted & notice mailed.

5. Answer to petition and order to show cause filed.

6. June 7, 1963. Notice of appeal by respondents, filed. Copy to U. S. Atty. on 6-7-63.

7. June 7, 1963. Copy of Clerk's notice to U. S. Court of Appeals, filed.

   June 7, 1963. Respondents' bond for costs on appeal in $250. with The Travelers Indemnity Co. as surety, filed.

8. June 8, 1963. Stipulation of counsel and Order of Court postponing Order of this Court entered June 5, 1963, pending appeal, filed. 6-10-63 noted & notice mailed.

5. June 5, 1963. Answer to petition and order to show cause, filed.

9. June 12, 1963. Transcript of hearing of 6-5-63, filed.

ORDER TO SHOW CAUSE.

Upon the petition, the exhibits attached thereto, the affidavit of Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, and upon the motion of Drew J. T. O'Keefe, United States Attorney.

BE IT ORDERED, that Max Powell, President of William Penn Laundry, Inc., appear before the District Court of the United States for the Eastern District of Pennsylvania, in that branch thereof presided over by the undersigned, in his Court Room in the U. S. Courthouse on June 5, 1963, at 10 A. M. to show cause why he should not be compelled to produce the papers, books and records demanded in the Internal Revenue Summons served upon him on March 13, 1963, by the petitioner.

LET A COPY OF THIS ORDER, together with the petition and the exhibits attached thereto, be served personally upon the said MAX POWELL at least five days prior to the time set herein for hearing.

Dated at Philadelphia, Pennsylvania, this 27th day of May, 1963.

By THE COURT:

/s/ ALLAN K. GRIM,
United States District Court Judge.

PETITION TO ENFORCE INTERNAL REVENUE SERVICE SUMMONS.

Come now the United States of America and Ernest J. Tiberino, Jr., by their attorney, Drew J. T. O'Keefe, United States Attorney for the Eastern District of Pennsylvania, and show unto this Court as follows:

I.

This is a proceeding brought under the authority of Section 7604(b) of the Internal Revenue Code of 1954 to judicially enforce an Internal Revenue Summons.

II.

The petitioner, Ernest J. Tiberino, Jr., is a Special Agent of the Internal Revenue Service employed in the Intelligence Division of the office of the District Director located at Philadelphia, Pennsylvania.

III.

The respondent, William Penn Laundry, Inc., is a corporation incorporated pursuant to the laws of the Commonwealth of Pennsylvania and maintains its principal place of business within the city of Philadelphia, Pennsylvania.

IV.

The respondent, Max Powell, resides at 6138 Old York Road, Philadelphia, Pennsylvania.

V.

The petitioner, Ernest J. Tiberino, Jr., is conducting an examination of the books and records of the respondent, William Penn Laundry, Inc., for the purpose of ascertaining the correctness of corporate income tax returns filed by

the respondent; William Penn Laundry, Inc., for its fiscal years ending July 31, 1958, and July 31, 1959.

VI.

On February 26, 1963, Dean J. Barron, Regional Commissioner, Internal Revenue Service, a delegate of the Secretary of the Treasury, notified in writing, the respondent, William Penn Laundry, Inc., that an additional inspection of its books and records was necessary. Exhibit "A-2" which is attached hereto and incorporated herein is a copy of said notification the original of which was previously delivered to Max Powell, President of the said respondent by Ernest J. Tiberino, Jr., on March 4, 1963, as appears more fully in the affidavit of the said Ernest J. Tiberino, Jr., which is attached hereto as Exhibit "A-1".

VII.

On March 12, 1963, a summons was issued by Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, directing the respondent, Max Powell, as President of William Penn Laundry, Inc., to appear before the said Ernest J. Tiberino, Jr., on March 25, 1963, at 10:00 A. M., and to produce for examination certain books, records and papers of William Penn Laundry, Inc. A copy of said summons was personally served upon Max Powell by the said Ernest J. Tiberino, Jr., on March 13, 1963, and is attached hereto as Exhibit "B".

VIII.

The respondent; Max Powell, appeared in response to the summons described in paragraph VII above, but refused to produce the books, records, and papers demanded, and such refusal continues to the date of this petition as is all more fully set out in the transcript of testimony attached hereto as Exhibit "C".

WHEREFORE, the petitioners respectfully pray:

1. That the Court enter an order directing the respondents, William Penn Laundry, Inc., and Max Powell, as President of the respondent corporation, to show cause, if any they have, why they should not comply with and obey the aforementioned summons in each and every requirement thereof.

2. That the Court enter an order directing the respondent, Max Powell, to obey the aforementioned summons in each and every requirement thereof, and to order the attendance and production of books and records as required and called for by the terms of such summons before Special Agent Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service, at such time and place as may be hereafter fixed by said Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service.

3. That the Court grant such other and further relief as to the Court may seem just and proper.

/s/ DREW J. T. O'KEEFE,
Drew J. T. O'Keefe,
United States Attorney.

/s/ SIDNEY SALKIN,
Sidney Salkin,
Asst. United States Attorney.

UNITED STATES OF AMERICA
EASTERN DISTRICT OF PENNSYLVANIA } *ss.:*

I, Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, do hereby make a solemn oath that the statements contained in the foregoing petition are true to the best of my knowledge, information and belief.

/s/ ERNEST J. TIBERINO, JR.
Ernest J. Tiberino, Jr.

Subscribed and sworn to before me this 20th day of May, 1963.

/s/ RICHARD DICERBO,
Dep. Clerk, U. S. D. C., E. D. Pa.

EXHIBIT "A-1".

AFFIDAVIT.

UNITED STATES OF AMERICA
EASTERN JUDICIAL DISTRICT OF PENNSYLVANIA } *ss.:*

Ernest J. Tiberino, Jr., being duly sworn, according to law, deposes and says:

(1) That he is a Special Agent, Intelligence Division, Office of the District Director of Internal Revenue, Philadelphia, Pennsylvania.

(2) That since February 1963, in his capacity as a Special Agent, he has been investigating the correctness of the corporation income tax returns of William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959.

(3) That based upon the above investigation, the Regional Commissioner, Internal Revenue Service, determined that an additional examination pursuant to Section 7605(b) of the books and records of the William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959, was necessary.

(4) That pursuant to Section 7605(b) on March 4, 1963, he delivered to Max Powell, President, William Penn Laundry, Inc., a letter dated February 26, 1963, from the Regional Commissioner of the Internal Revenue Service which notified the William Penn Laundry, Inc., that an additional inspection of their books and records was necessary. A copy of said letter is attached to this affidavit and marked Exhibit "A-2".

(5) That on the basis of the information obtained in the above investigation, he has reason to suspect that the

William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958, and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years.

(6) That it is necessary to inspect the books and records demanded in the summons to ascertain the correctness of said returns and whether said returns were false and fraudulent.

/s/ ERNEST J. TIBERINO, JR.

Subscribed and sworn to before me this 20th day of May, 1963.

/s/ RICHARD DICERBO,
Dep. Clerk, U. S. D. C., E. D. Pa.

EXHIBIT "A-2".

U. S. TREASURY DEPARTMENT
Internal Revenue Service
Regional Commissioner
Fifth Floor
2 Penn Center Plaza
Philadelphia 2, Pa.

In Reply Refer to
I:R

February 26, 1963

William Penn Laundry, Inc.
4112 Frankford Avenue
Philadelphia, Pennsylvania

Gentlemen:

While it is the practice of the Internal Revenue Service to make as few inspections of books of account and records of taxpayers as possibile, it is deemed necessary to make a reinvestigation of the books and records of the William Penn Laundry, Inc. for the fiscal years ending July 31, 1958 and July 31, 1959 in order to properly verify its returns for those years. A re-examination, therefore, will be made.

Your cooperation in permitting our representative access to all of the company's books and records will be appreciated.

This notice is sent in compliance with Section 7605 of the Internal Revenue Code of 1954.

Very truly yours,

(Signed) Dean J. Barron
Dean J. Barron
Regional Commissioner

EXHIBIT "B".

U. S. TREASURY DEPARTMENT
Internal Revenue Service

Form 2039

SUMMONS

In the matter of the tax liability of

William Penn Laundry, Inc.
4100 Frankford Avenue
Philadelphia 24, Pennsylvania
Internal Revenue District of Philadelphia

Period(s) FYE 7-31-58 and FYE 7-31-59

THE COMMISSIONER OF INTERNAL REVENUE

To: Max Powell, President

At: William Penn Laundry, 4100 Frankford Avenue, Philadelphia

GREETING:

You are hereby summoned and required to appear before Ernest J. Tiberino, Jr., an officer of the Internal Revenue Service, to give testimony relating to the tax liability and/or the collection of the tax liability of the above named person for the period(s) designated and to bring with you and produce for examination the following books, records, and papers at the time and place hereinafter set forth:

Minute books
Stock certificate books
General ledgers
General journals
Purchase journals and cash disbursement journals
Sales journal and cash receipts journals
and all subsidiary records kept to substantiate the entries in the above-mentioned records.

Place and time for appearance:

At Office of the Intelligence Division, Internal Revenue Service, Mezzanine Floor, 401 N. Broad St., Phila. on the 25th day of March, 1963, at 10 o'clock A. M.

Failure to comply with this summons will render you liable to proceedings in the district court of the United States or before a United States Commissioner to enforce obedience to the requirements of this summons, and to punish default or disobedience.

Issued under authority of Section 7602, Internal Revenue Code of 1954

this 12th day of March, 1963.

ORIGINAL

Signature: ERNEST J. TIBERINO, JR.
Ernest J. Tiberino, Jr.
Title: Special Agent

Exhibit "B"

CERTIFICATE OF SERVICE OF SUMMONS

(Pursuant to Section 7603, Internal Revenue Code of 1954)

I hereby certify that I served the summons on the reverse hereof

Date Summons Served (*Day, month, year*)	Time
On March 13, 1963	8:45 AM

How Summons Was Served (Check one)

× I handed an attested copy thereof to the person to whom it was directed,

☐ I left an attested copy thereof with the following person at the last and usual place of abode of the person to whom it is directed,

Signature	Title
ERNEST J. TIBERINO, JR.	Special Agent

Sec. 7603. Service of Summons.—A summons issued under section 7602 shall be served by the Secretary or his delegate, by an attested copy delivered in hand to the person to whom it is directed, or left at his last and usual place of abode; and the certificate of service signed by the person serving the summons shall be evidence of the facts it states on the hearing of an application for the enforcement of the summons. When the summons requires the production of books, papers, records, or other data, it shall be sufficient if such books, papers, records, or other data are described with reasonable certainty.

Form 2039 (5-55)

EXHIBIT "C".

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Testimony of

MAX S. POWELL
6138 Old York Road
Philadelphia, Pennsylvania

In re

William Penn Laundry, Inc.
4100 Frankford Avenue
Philadelphia, Pennsylvania

Testimony of MAX S. POWELL, 6138 Old York Road, Philadelphia, Pennsylvania, taken in the office of the Intelligence Division, Internal Revenue Service, 401 North Broad Street, Philadelphia, Pennsylvania, at 9:55 A. M., on Monday, March 25, 1963, in the matter of the income tax liability to the United States of William Penn Laundry, Inc., 4100 Frankford Avenue, Philadelphia, Pennsylvania.

PRESENT

Max S. Powell ..... Witness
Herbert S. Mednick, Esq. ...Representing Witness
Packard Building
Philadelphia 2, Pennsylvania
Ernest J. Tiberino, Jr. .....Special Agent
Coleman Raines .....Internal Revenue Agent
Virginia M. Arner .....Reporting Stenographer

Questions were asked by Special Agent Tiberino and answers made by Mr. Powell, unless otherwise indicated.

Mr. Tiberino: Mr. Powell, I will be directing my questions to you. You were served with a Treasury Department summons and requested to appear here today to give testimony and furnish records in the matter of the tax liability of William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959.

1. Q. Would you please stand and raise your right hand. Do you swear that the answers you are about to give to the questions asked will be the truth, the whole truth, and nothing but the truth, so help you, God?

A. I do.

2. Q. Be seated please. What is your full name?

A. Max, M-A-X, S. Powell, P-O-W-E-L-L.

3. Q. And your home address?

A. 6138 Old York Road, Philadelphia.

(—1—VMA—MSP)

4. Q. And who is with you today, Mr. Powell?

A. Mr. Herbert Mednick, counsel for William Penn Laundry, Incorporated.

Mr. Tiberino: I would like the record to show that Mr. Mednick has produced a U. S. Treasury Department enrollment card showing date March 18, 1963.

Let the record show that there is a power of attorney on file with the District Director of Internal Revenue dated March 21, 1963, whereby Mr. Mednick is shown as the representative of William Penn Laundry, Incorporated.

Mr. Tiberino (resuming):

5. Q. Mr. Powell, what is your position with the William Penn Laundry?

A. My present position is President and Treasurer.

6. Q. And how long have you held these positions with William Penn Laundry?

A. After Mr. Kline's decease. I don't know the months. I don't know the exact date.

Mr. Mednick: Approximately.

(A. No. 6 cont'd.) Approximately—Mr. Kline deceased in October 2, 1961, and sometime after that, when I was elected. Sometime after that; not immediately.

Mr. Tiberino (resuming):

7. Q. Prior to October, 1961, what position did you hold with William Penn Laundry?

A. Vice President and Secretary.

8. Q. Mr. Powell, you were requested to bring with you certain corporate records of William Penn Laundry for the years ending 7/31/58 and 7/31/59, namely, minute books. Do you have them with you today?

A. I do not have them with me today because, on the advice of our counsel, Herbert Mednick, Esq., I did not bring those books.

9. Q. You were also requested to bring stock certificate books of the corporation. Do you have those with you today?

A. On the advice of our counsel I did not bring them. I accepted the advice of our counsel.

(—2—VMA—MSP)

10. Q. You were also requested to bring general ledgers of the corporation for those years. Do you have those with you today?

A. On the advice of our counsel, I did not bring them.

11. Q. You were also requested to bring general journals.

A. I did not.

12. Q. Any reason for not bringing the journals?
A. On the advice of counsel.

13. Q. Also requested were purchase journals and cash disbursements journals. Do you have those with you?
A. I do not. On the advice of counsel I did not bring them.

14. Q. Also requested were sales journals and cash receipts journals. Do you have those with you today?
A. I did not bring them, on advice of counsel.

15. Q. You were also requested to bring subsidiary records to substantiate the records I just mentioned. Do you have any records at all with you today?
A. I do not have any records with me today on the advice of counsel.

Mr. Tiberino: And I presume, Mr. Mednick, that at this point you would like to give your position?

Mr. Mednick: That is correct. I would like to make a statement, if I might.

Mr. Tiberino: Go right ahead.

Mr. Mednick: Mr. Powell is here today in his capacity of President of the William Penn Laundry, Inc. to honor the summons which was served upon him. It is his desire, and the company's desire, to cooperate in every way that is proper and legal. However, in view of the fact that the Statute of Limitations has expired for the two years for which time you have requested records, plus the fact that these years were previously examined and the principal officer at the time is no longer living, I have advised Mr. Powell to decline to produce these records and to waive any legal rights which the corporation may have or which he may have.

It is our position that this is an unreasonable examination, and in view of the expiration of the Statute of Limitations, such examination would be illegal. To Mr. Powell's knowledge, the returns of

(—3—VMA—MSP)

the corporation for the years in question are correct and he has no reason to know of any discrepancies which could be the basis for an allegation of fraud. Under the circumstances, unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years.

This position is taken on the basis of substantial legal authority, the most recent of which is the case of *John A. Howard, 63-1 USTC, Paragraph 9201*, which was decided this year before United States District Court for the Western District of Pennsylvania. I point out that the Judge, in that decision, cited as authority a case decided by the Court of Appeals for this Circuit, the Third Circuit, *Zimmerman v. Wilson*, 105 Fed(2) 583.

If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the Statute of Limitations provision in the Internal Revenue Code.

Mr. Tiberino: O. K. gentlemen, in view of the position taken today, there is no point in carrying this meeting any further at this time.

Mr. Tiberino (resuming):

16. Q. Mr. Powell, is there anything further you wish to say at this time?

A. I accept the advice of my counsel.

Mr. Mednick: Excuse me. [To Mr. Powell] You said "advice of counsel". Would you confirm the fact that the "advice" is related to the Statute of Limitations?

(A. No. 16 cont'd.) Relating to the Statute of Limitations.

Mr. Mednick: Can I ask him a question? [To Mr. Powell] Are you a shareholder of William Penn Laundry?

Mr. Powell: No, I am not.

Mr. Mednick: Have you ever been a shareholder?

Mr. Powell: I have not.

(—4—VMA—MSP)

Mr. Mednick: Who was the principal officer and operator of William Penn Laundry prior to October, 1961?

Mr. Powell: Lawrence C. Kline.

Mr. Mednick: Thank you.

Mr. Tiberino: Is that it, gentlemen?

Mr. Mednick: Yes, sir.

(10:10 A. M.)

[The statement was reopened at 10:11 A. M. in order that the following pertinent statement might be included in the record:]

Mr. Tiberino: Do you have any request to make, Mr. Mednick, for the record?

Mr. Mednick: In view of the fact that Mr. Powell is here pursuant to compulsory process and the Administrative Procedures Act provides for the obtaining of a copy of the transcript where a witness is sum-

moned to appear before a Federal administrative body, I respectfully request that Mr. Powell be given a copy of the record of his testimony within the next week or two, or a reasonable period. He will, of course, be willing to sign such transcript after he has reviewed it for accuracy.

Mr. Tiberino: At this time, Mr. Mednick, I will say that your request will be considered.

(10:12 A. M.)

(—5—VMA—MSP)

Exhibit "C"

UNITED STATES OF AMERICA
EASTERN JUDICIAL DISTRICT OF PENNSYLVANIA } *ss.:*

I have carefully read the foregoing statement, consisting of 5 pages, which is a transcript of questions which were propounded to me and my answers to such questions on the 25th day of March, 1963, at Philadelphia, Pennsylvania, relative to the income tax liability to the United States of William Penn Laundry, Inc., 4100 Frankford Avenue, Philadelphia, Pennsylvania. I hereby certify that the foregoing answers are true and correct, and that I have made the corrections shown and have placed my initials opposite each correction, and that I have initialed each page of the statement.

MAX S. POWELL.

Subscribed and sworn to before me at 10:30 A. M., this 8th day of April, 1963, Intelligence Division, I. R. S., 401 North Broad St., Phila., Pa.

ERNEST J. TIBERINO, JR.,
Ernest J. Tiberino, Jr.,
Special Agent.

(—6—)

Max S. Powell

I, Virginia M. Arner, Report Stenographer, do hereby certify that I took the foregoing statement of Mr. Max S. Powell in shorthand and personally transcribed it from my shorthand notes, and I have initialed each page.

March 25, 1963 VIRGINIA M. ARNER.
(Date)

I, Ernest J. Tiberino, Jr., Special Agent, do hereby certify that, to the best of my recollection, the above is a true transcript of questions propounded to Mr. Max S. Powell and answers given by him at the above time and place.

3-26-63 ERNEST J. TIBERINO, JR.
(Date)

I, Coleman Raines, Internal Revenue Agent, do hereby certify that, to the best of my recollection, the above is a true transcript of questions propounded to Mr. Max S. Powell and answers given by him at the above time and place.

4/8/63 COLEMAN RAINES.
(Date)

RESPONSE TO ORDER TO SHOW CAUSE.

Comes now Max Powell and William Penn Laundry, Inc., by their attorneys, Fred L. Rosenbloom and Herbert S. Mednick, and show as follows:

I.

William Penn Laundry, Inc. is a Pennsylvania corporation, with its principal place of business in Philadelphia, Pennsylvania. Max Powell, a resident of Philadelphia, Pennsylvania, is presently president of William Penn Laundry, Inc.

II.

In the present proceeding, Ernest J. Tiberino, Jr., a Special Agent of the Internal Revenue Service, seeks judicial enforcement of an Internal Revenue Summons compelling the production by William Penn Laundry, Inc. and Max Powell, of books and documents for the fiscal years ending July 31, 1958 and July 31, 1959.

III.

During the years in question, Lawrence Kline was president of William Penn Laundry, Inc., and owned 100% of its stock. Lawrence Kline died in October, 1961.

IV.

After the death of Lawrence Kline, Max Powell was elected president of the William Penn Laundry, Inc. Max Powell has no stock interest in the corporation.

V.

The tax returns for the years here involved, namely, the fiscal years ending July 31, 1958 and July 31, 1959,

were timely filed, and have heretofore been examined by Agents of the Internal Revenue Service, at which time all of the books and records of William Penn Laundry, Inc. were made available to them. Pursuant to such examination, adjustments were made and deficiency taxes were assessed and, in due course, paid.

VI.

Section 6501 of the Internal Revenue Code provides that except as otherwise provided in the Section the amount of tax imposed shall be assessed within 3 years after the return was filed. More than 3 years have elapsed since the returns for the years in issue were filed.

VII.

The Internal Revenue Summons here involved, served March 13, 1963, without any reference to the above stated facts, demanded that the taxpayer comply with a sweeping order to turn over to Special Agent Ernest J. Tiberino, Jr. all of its books and records for the fiscal years ending July 31, 1958 and July 31, 1959. The Summons had been preceded by a letter to the taxpayer dated February 26, 1963, signed by the Regional Commissioner of the Internal Revenue Service, advising the taxpayer that a re-examination was going to be made of the taxpayer's books for the fiscal years in question.

VIII.

On March 25, 1963, an administrative hearing was held in connection with the Internal Revenue Summons here involved, at which hearing the taxpayer called attention to the statute of limitations bar and, through its counsel, requested Special Agent Tiberino to give some justification for attempting to open the closed years in question, stating that the taxpayer would be willing to reconsider its position

if such justification were offered. Special Agent Tiberino declined to give any justification for the decision to re-examine the fiscal years in question or for the demand by Summons that the taxpayer produce all of its books for the closed years.

IX.

In view of the above described refusal to offer any justification, the taxpayer declined to comply with the Internal Revenue Summons, standing on its legal right to do so.

Thereafter, the instant application was made by Special Agent Tiberino to this honorable Court for enforcement, as though the matter involved an ordinary action for judicial enforcement of an administrative subpoena.

WHEREFORE, Max Powell and William Penn Laundry, Inc. respectfully request that the Order to Show Cause heretofore issued in this matter be dissolved and that the motion for enforcement of Special Agent Ernest J. Tiberino, Jr. be denied.

/s/ FRED L. ROSENBLOOM
Fred L. Rosenbloom

/s/ HERBERT S. MEDNICK
Herbert S. Mednick,
Attorneys for Max Powell and William Penn Laundry, Inc.

SCHNADER, HARRISON, SEGAL & LEWIS,
1719 Packard Building,
Philadelphia 2, Pennsylvania,
Of Counsel.

June 5, 1963.

EXCERPT FROM TRANSCRIPT OF HEARING OF JUNE 5, 1963 RE: ORDER TO SHOW CAUSE.

(2) *

Mr. Fuerth: Your Honor, Basically we brought this petition in order to enforce compliance with an Internal Revenue summons that was issued by Ernest J. Tiberino, and I think as is set out in our affidavit, the agents of the Internal Revenue Service have been investigating the correctness of the corporate income tax returns for the William Penn Laundry for the fiscal years ending July 31st, 1958 and July 31st, 1959 since approximately either the end of January or the beginning of February.

The Court: Is summons the correct word, or subpoena?

Mr. Fuerth: No, this is captioned a summons.

The Court: That's according to the statute?

Mr. Fuerth: Yes, the summons is issued pursuant to

(3)

Section 7602 of the Internal Revenue Code of 1954 and this proceeding is brought under the provisions of Section 7604 of the Internal Revenue Code of 1954.

Basically what has happened is, after a sort of—the initial investigation—it was determined that a further investigation was warranted, and the Regional Commissioner of the Internal Revenue, Dean J. Barron, after investigation, sent a letter to the William Penn Laundry, the date of which, I believe, is February 26th, 1963, informing them that he wished to have reinvestigation of their books and records for that year, and subsequent to that time and pursuant to this investigation, the special agent issued a summons directing that the William Penn Laundry and Max

* Figures in parentheses refer to page numbers of typewritten transcript.

Powell, President, bring in the matters that were listed in the summons; the minute books, the stock certificate books, the general ledgers, the general journals, purchase journals and cash disbursements journals; sales journal and cash receipts journals, and all subsidiary records kept to substantiate the entries in the above mentioned records.

The summons was issued on March 12th and was served on the President the following day, March 13th, and was returnable on March 25th. That is basically what underlies this proceeding.

Now, what I would like to suggest to your Honor,

(4)

it is only a matter of suggestion, is that basically these problems involve a dispute between the position taken in the First Circuit and the position taken in the Ninth Circuit as to the showings that the Government must make for the enforcement of this summons. This is usually referred to as a showing of probable cause.

Apparently what the defense, or the objection of the respondents in this case have, is that the statute of limitations, three year statute of limitations bars a further assessment of taxes for the two fiscal years being investigated, absent a finding of fraud. If there is fraud, of course, the statute of limitations does not apply, and the First Circuit has taken the position that the Government must make a showing of probable cause if fraud exists.

The Court: Probable cause or good cause?

Mr. Fuerth: No, it has been captioned probable cause.

The Court. In civil rules, you know, the one you use to get documents including books for civil—for discovery in civil cases, and that uses the phrase "good cause".

Mr. Fuerth: Yes, and in opposition the Second Circuit has taken the position that the Government need not make such a showing.

(5)

The Court: Probable cause of what?

Mr. Fuerth: Probably cause that fraud exists. In other words——

The Court: Is that——

Mr. Fuerth: May I go a little further? The real question is whether or not this examination is reasonable and the position, of course, is that the examination is not reasonable because the statute of limitations bars any further assessment unless there is fraud.

Now, what I would like to suggest to your Honor, since this does not involve a dispute between these—primarily these two Circuits, but other Circuits have ruled on it that ——

The Court: Just a minute. How can you determine whether there is fraud or this willfullness which is always —income tax records require—unless you can examine for it?

Mr. Fuerth: That basically is our position. Our position is that we are, in effect, being required to show the very fact that we are attempting to establish, sort of chasing our own tail.

The Court: I think it would probably go maybe more to the mind of the Judge than anything else. He might be pretty liberal in permitting an examination because without the complete examination you can't establish the willfullness

(6)

You call it fraud, but the statutes all say willfullness, I think

Mr. Fuerth: Yes.

The Court: Go ahead.

Mr. Fuerth: What I was going to suggest before going further, since it does involve the decisions in a number of Circuits, I was going to suggest we set up a briefing schedule, if Your Honor would like, and present briefs before argument. After Your Honor has had the opportunity to look at briefs——

The Court: No, let's go right ahead this morning.

Mr. Fuerth: All right, fine.

The Court: I have tried so many income tax cases and I have had so much experience with these things, I don't see why we should delay it.

Mr. Fuerth: I am perfectly willing to proceed. I was going to suggest that.

Basically, Your Honor, the position is that under the summons as issued under the authority of Section 7602 which allows the Service to issue a summons for the purpose of ascertaining the correctness of any return, making a return when none has been made, determining the liability of any person for any Internal Revenue Tax, or the liability

(7)

of law or in equity—and then they go on to say to summon any person having possession, custody or care of books of accounts containing the entries relating to the business of the person liable for tax, or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear——

The Court: That was a long sentence, so I—you did all right on that one, but hereafter, if you intend to use sections of the statute, I would prefer that you read the statute instead of your summary, what you think they mean.

Mr. Fuerth: I appreciate that.

The Court: In order to state exactly what the statute does mean, but that was pretty clear.

Mr. Fuerth: Well, the summons was issued on the authority of that particular section, and the only limitation that the Code provides on this, or substantive restriction, actually, is provided in Section 7605(b) of the Internal Revenue Code of 1954, which uses the words that, "no taxpayer shall be subjected to unnecessary examination or investigation," and it goes on to say, "only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise," or the Secretary advises him in writing.

The Court: You mean if they go over the books

(8)

and later on they think they forgot something, they'd like to do it again, the taxpayer can say no, you are not going to go over it again?

Mr. Fuerth: Unless the Service makes an investigation and notifies them in writing that they intend to do so.

The Court: But I assume you do that just as a matter of decency in any case.

Mr. Fuerth: This is really what Congress intended. It was intended that the taxpayer not be harassed with repeated and repeated efforts to get his books, but if there is some basis for it, the Code contemplates that an additional investigation be made and this is what was done when the Regional Commissioner, Dean J. Barron, mailed a letter to the William Penn Laundry which is a—a copy of which is attached to the Petition and this is the summons that was issued after the oral request to turn over these records was not complied with.

Now, Your Honor, it is our position, or the Government's position, that the law that we would like this Court to accept was set out in the case of Foster versus United States, 265 Fed. 2d 183. It is a Second Circuit Court case in which they state that the Government should not be re-

quired to prove grounds for belief that the liability was not time barred.

(9)

Basically they say that for a summons to be unreasonable within the meaning of Section 7605 does not require the Government to show that this liability was barred by the statute of limitations.

The Court: Has more than three years expired?

Mr. Fuerth: Yes. The tax years involved are the fiscal years ending July 31st, 1958 and July 31st, 1959.

The three year period limitation for the '58, of course, expired in 1961.

The Court: Therefore the burden is on the Government to show that there was willfullness or fraud, and your proof has to go into that.

Mr. Fuerth: In a tax prosecution or collection case, Your Honor.

The Court: How about the problem here of getting the summons?

Mr. Fuerth: Our position, Your Honor, is that in order to establish this case these are the very books that we need to establish it. We feel that the reason——

The Court: Can you establish it when obviously the statute of limitations has run unless you can show fraud?

Don't you have to start out by showing that there is fraud or willfullness before you can make me move at all, because my first reaction is, well, the statute of

(10)

limitations has run.

Mr. Fuerth: The statute of limitations, Section 6501 of the Code, refers to the assessment and collection of the taxes.

The Court: Not to the issuing of the summons?

Mr. Fuerth: Not to the issuance of the summons.

The Court: Then what could the defense be if you show there is good and probable cause, and I am satisfied there is probable cause of a crime; then it will automatically follow.

Mr. Fuerth: This is our——

The Court: That's simple enough. Let's get to the trial.

Mr. Fuerth: Your Honor, it is our position that we have made this showing in the affidavit. It was the affidavit by the agent submitted hereto. It is our position that——

The Court: If we are having a hearing here I am not trying this case on affidavits, I am trying it on live witnesses.

Go ahead with your live witnesses.

Mr. Fuerth: Your Honor, I have no live witnesses. It is our position that this is a matter that can be tried on affidavits. I don't mean to be disrespectful to the Court.

The Court: What does the statute say about

(11)

a hearing? Why am I here this morning?

Now, you quote the statute as to why I am here this morning. I don't want your summation, what you think it says.

Mr. Fuerth: It is Section 7604 of the Internal Revenue Code which provides enforcement. "When any person summoned under Section 7602"—which is the applicable statute —"neglects or refuses to obey such summons, or to produce books, papers, records or other data, or to give testimony, as required, the Secretary or his delegate, may apply to the Judge of the District Court, or to a United States Commis-

sioner for the District within which the person so summoned resides or is found for an attachment against him, as for a contempt. It shall be the duty of the judge or the commissioner to hear the application and if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case,"——

The Court: That means you have to carry a burden of showing that as a proof. Now, those are the words used in the statute. You know we don't try cases on affidavit, we try cases on live witnesses.

Why do you think you can come into a hearing now and say we won't produce any witnesses, we have an affidavit?

(12)

Why is this any different from any other kind of a hearing that we have in court?

Mr. Fuerth: Your Honor, I am not requesting this Court to make an attachment, I am merely asking this Court to make an order which can——

The Court: Well, I haven't read the affidavit but I assume it contains enough to establish the prima facie case.

Mr. Fuerth: Yes, the affidavit, if I may read from it——

The Court: Well, no, you needn't do that. I will hear from the other side.

I will disagree very violently on some of these things, but let's hear from the other side.

Mr. Rosenbloom: May it please the Court, briefly the basic factual situation here set forth is in a response which we have filed and served on counsel for the Special Agent and the petition involves the income tax liability, as my worthy adversary has said, of the William Penn Laundry and Max Powell as President for the fiscal years ending July 31st, 1958 and July 31st, 1959.

Returns for each of those years were timely filed and each of those returns was carefully audited by an agent of the Internal Revenue Service.

(13)

Pursuant to those audits, at which time all the books and records involving the summons presently before the Court were made available to the agents, and to the extent they deemed necessary were carefully examined and carefully reviewed, following which adjustments were made and some deficiency taxes were assessed, and in due course paid.

Now, more than three years after the returns in question were filed——

The Court: Was any suggestion ever made that this man was guilty of what the Government has called fraud or willful failure to pay, or anything like that?

Mr. Rosenbloom: Not to my knowledge, Your Honor.

May I read this affidavit which is attached to the pleadings?

The Court: Yes.

Mr. Rosenbloom: As soon as I can find it.

The allegation number 5 in the affidavit, which is a conclusory document, by the way, it doesn't state facts, goes on to say:

> "That on the basis of the information obtained in the above investigation, he has reason to suspect that the William Penn Laundry, Inc. has filed false and fraudulent corporate income tax returns for its fiscal years ending

(14)

> July 31st, 1958 and July 31st, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made, which in turn were used as expenses—" and so on and so on.

Now, he has done this. I have no facts nor has the Court any facts on which to support his conclusion that fraud exists. Now, I would like to develop this, Your Honor, in my argument.

By the way, Mr. Fuerth neglected to state that while it is true we have no authority from the Court of Appeals in this Circuit, we have two recent cases decided by District Courts in this Circuit, one by the Western District in Pittsburgh, one by the District in Delaware, directly on point, and in neither case was the Government's request supported.

In both cases—in one case it was a motion by the taxpayer to quash a subpoena and that was granted, and the other case was a matter by—a motion by the Government in a situation such as this, and it was denied, so we do have authority.

We are not in the Second Circuit, we are in the Third Circuit, and we have two cases right on point, one of them decided only two weeks ago.

Meanwhile I would like to hand those up to

(15)

Your Honor.

The Court: In Delaware?

Mr. Rosenbloom: Yes, Judge Wright.

The Court: Who was the Judge in the Western District?

Mr. Rosenbloom: Judge Dumbauld.

May I call Your Honor's attention to Judge Wright's opinion in the Carey case, and I am going to quote from—if Your Honor will permit me to point this language out to you on page 88359. This is directly on point.

May I read it, sir, for the record?

The Court: I am reading it from this.

Go ahead.

Mr. Rosenbloom: I would like now to develop my thought. Now, more than three years after the returns in question were filed and without any attempt to justify or explain the action, a demand was made on the taxpayer by a Regional Commissioner's letter of February 26th, 1963, that the taxpayer permit another examination of all the books and records for those two years.

The Court: How long did they have them the first time?

Mr. Rosenbloom: I don't know, Your Honor. All I know is that from my own experience as a Revenue Agent, you

(16)

come out and ask for the books and records. They are presented to you as they were here. You make an examination on the taxpayer's premises and you keep them as long as you, the examining officer, feel it is necessary.

Now, a full examination was made. I assume the Revenue Agent did his duty. He made an examination. He made some changes which resulted in deficiency taxes. He discussed those with the taxpayer or the taxpayer's representatives. They were agreed upon, the amounts were assessed and the assessments were ultimately paid.

Now, more than three years later without any notice, along comes this Commissioner's letter in which he states it is deemed necessary—deemed by whom? and on what basis? It is deemed necessary to make this reexamination.

The Court: What actually happened? Was a new man put on the job, do you know?

Mr. Rosenbloom: Yes, a Special Agent, a Special Intelligence Agent this time. We don't know why, we don't know the basis for it; all we know is he comes in and asks for a reexamination. If I may go on I will develop this.

Mr. Max Powell, who is now the President of this corporation—a man who was President of the corporation at

the time involved in these two years, in these two returns, died in October, 1961—the President, Mr. Max Powell,

(17)

accompanied by Mr. Mednick, one of my partners, appeared at a hearing before Special Agent Tiberino in answer to the first summons in March, 1963, to explore the situation.

At that time, Mr. Mednick made the following statement which I quote from the transcript of the hearing which was attached to the petition. I am now quoting. Mr. Mednick said to Mr. Tiberino:

> "If you would be willing to give us some indication of the allegation here, or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the statute of limitations provision in the Internal Revenue Code."

The Special Agent's response to this statement was the remark that there was— ". . . no point in carrying this meeting any further at this time."

In other words, and this has since been made clear in subsequent conversations with the Special Agent, the Service flatly refused to furnish any justification for its demand that the closed years be reopened.

In view of the situation which developed at this hearing, the taxpayer had no alternative——

The Court: Mr. Rosenbloom, is Mr. Tiberino here today?

(18)

Mr. Rosenbloom: No, I don't see him.

The Court: He is the Special Agent. I don't see why he isn't here to testify and give me some explanation aside from this affidavit so he can be cross-examined.

Mr. Rosenbloom: Well, I am not responsible for Mr. Tiberino, but I can say this to Your Honor. I know this

is the attitude of the Internal Revenue Service. They want it. That is sufficient.

The Court: They are going to run right over all the taxpayers to get it.

Mr. Rosenbloom: Not all of them.

The Court: —whenever they want something, and that isn't the attitude Congress wants, or the Courts want. He won't even bother to come in here to testify to say why he wants it.

Mr. Rosenbloom: This is not the reason why Congress put a statute of limitations in the law. They didn't put it in for makeweight.

The Court: I wonder if it is necessary to take any time with this.

Mr. Fuerth—is that your name?

Mr. Fuerth: Yes, sir.

The Court: Suppose I give you folks an hour to go over these books. Would that be enough?

(19)

Mr. Fuerth: Your Honor——

The Court: Why spend any more time on this. I don't think any more of Mr. Powell's time should be taken on this examination than is absolutely necessary.

Mr. Rosenbloom: Mr. Powell is here, by the way.

The Court: I suspected that was Mr. Powell.

Mr. Fuerth: Your Honor, I am informed by the—someone from the Internal Revenue Service here, that an hour would be sufficient.

The Court: Well now, why fight over a problem that would only take an hour? I am inclined to go along with

Mr. Rosenbloom's argument from reading this, but as a practical matter, an hour examination of these books in a courteous way, understand—I don't know how the Special Agent acts, but if he will do this in a courteous way and a kindly way, without assuming these people are guilty of anything, I am inclined to let them have an hour to do this.

When would be the most satisfactory to you, Mr. Powell?

Mr. Rosenbloom: Mr. Powell is sitting back here. This is my partner, Mr. Mednick. Mr. Powell is in the courtroom.

The Court: Mr. Powell, will you come up for a minute?

Mr. Tiberino not having bothered to come here,

(20)

he will have to take the time I fix for him.

Mr. Fuerth: Your Honor, I can assure you Mr. Tiberino will comply with any order the Court makes, and that he will behave himself in a courteous and gentlemanly manner, there is no question about that.

The Court: They don't always.

Mr. Fuerth: Your Honor, you have my personal assurances that I will instruct him so.

The Court: When would be a convenient time for you, Mr. Powell. When would be a convenient time for you to let Mr. Tiberino have a look at them, not more than an hour, at your books?

Mr. Rosenbloom: Well, may I address myself to this, Your Honor? I am not at all certain that Mr. Tiberino or anybody else is entitled to this.

The Court: But they did it before.

Mr. Rosenbloom: But the statute has run, Your Honor.

The Court: He might have photographed the whole thing.

Mr. Rosenbloom: But the statute has run. This limitation was put in there by Congress for a purpose.

The Court: Yes, we can have a hearing here and we can have an argument in argument court, and you can present

(21)

findings of fact and conclusions of law, and I can present an opinion like the other Judges did.

For what? For an hour's time that Mr. Powell might give to Mr. Tiberino. He might think well, the principle is——

Mr. Rosenbloom: It is a very important principle, Your Honor.

The Court: Somebody apparently didn't do the examination thoroughly the first time and to me, compared with some of the other principles, it doesn't seem so important. I think the best way to handle this is to ask Mr. Powell when would be a convenient time for him and tell Mr. Fuerth that if Mr. Tiberino wants to see those books I will give him no more than an hour at that time to look at them and that, I think—it will be all over with. I don't mean the result of the investigation, the investigation will not be over, but as far as this particular aspect of it is concerned it will be over.

What would be a convenient time for you, Mr. Powell?

Mr. Powell: I would have to find out just exactly what time would be mutually convenient for Mr. Tiberino and myself.

The Court: No, you won't. You tell me what is

(22)

convenient and I will tell Mr. Fuerth that that's when Mr.

Tiberino will have to be there if he wants to see them. If he isn't there at that time he won't see the books.

He didn't come here to testify this morning to subject himself to cross-examination, so I am not too much concerned about his convenience.

Mr. Rosenbloom: But Your Honor, this is the real meat of this problem, whether he is entitled to see these books again.

The Court: I am not too much concerned about that.

Mr. Rosenbloom: If Your Honor is going to rule that he has the right to see them, that's one thing, but I don't think he should get another crack at these books just because he wants to see them. That's the crux of this case.

The Court: I know, but you aren't very practical in this, Mr. Rosenbloom.

Mr. Rosenbloom: Well, I have always considered myself quite practical.

The Court: No, I don't think in this—looking at it that way, you are making a big thing out of something that really isn't big. I don't think it is in the interest of your client or anybody else to be—make too big a thing out of this.

(23)

Mr. Rosenbloom: I think if Mr. Tiberino would tell us what he has in mind——

The Court: He does in this affidavit. He thinks the expenses, I think it is, were overstated.

Mr. Rosenbloom: He says he thinks that purchases were overstated.

The Court: How can they find out whether they were or weren't if they can't look at the books?

Mr. Rosenbloom: We will show them the purchases book.

The Court: Sure, that's——

Mr. Rosenbloom: I don't think Your Honor should ask us to open all of our books to him. If he wants to see the purchases book we will show the purchases book.

The Court: ". . . and has attempted to evade and defeat the taxes due for those years by overstating the amount of purchases made, which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years."

To a certain extent he can't substantiate it unless he looks.

Mr. Rosenbloom: I will show him the purchases book any time he wants to see it, but I don't think——

The Court: You are not going to limit him to

(24)

any particular book. I am going to let him have an hour to look at Mr. Powell's books, or less, if he can do it in less time, but no more.

Let's fix a time. How about next Monday?

Mr. Powell: I would——

Mr. Rosenbloom: Would next Monday be convenient?

The Court: I am not attempting to go over your head as a lawyer.

Mr. Rosenbloom: I understand, Your Honor.

The Court: This is a problem of convenience.

Mr. Fuerth: Your Honor, I would like to make a request. There are two gentlemen who have been working on this. Are you limiting it just to Mr. Tiberino' presence?

I would like the other gentleman who is working on the case with Mr. Tiberino to be present.

The Court: That will be all right, but I want the most considered courtesy, no browbeating or anything like that.

Mr. Fuerth: I assure you that I will instruct these gentlemen, and I will give the Court my personal assurance of that.

Mr. Rosenbloom: Will next Monday be satisfactory to you?

Mr. Powell: I believe it will, as far as I

(25)

myself am concerned. I would have to get all the books together.

Mr. Rosenbloom: Ten o'clock next Monday morning and——

The Court: Ten o'clock next Monday morning?

Mr. Rosenbloom: That is the purchase books? All the books and the time spent, as I understand Your Honor, is not to exceed beyond one hour from the time they start.

The Court: From ten to eleven in the morning. If they are not there by ten o'clock they will be cut off at eleven. You don't have to sit around all day waiting for them. Do you hear that, Mr. Fuerth?

Mr. Fuerth: Yes, sir.

The Court: Two men, but no more than two men.

Mr. Fuerth: That's right.

The Court: They will come there and they will treat you with the utmost courtesy.

Mr. Fuerth: I assure you.

The Court: I have very grave doubts. I think the practical way to handle this is to let them have that time in a courteous way to look at the books.

Now, do you want an order?

(26)

Mr. Rosenbloom: Yes, I would like an order.

The Court: The reason I ask that, Mr. Rosenbloom, is that there aren't any cases as far as I know in this District, and if I sign an order somebody will cite that, the fact that this point has been decided in the Eastern District, in the Western District and in Delaware.

If we try first of all to see if this won't work out without an order, then the motion can be withdrawn and nobody can say that this has been decided in the Eastern District, but if you want an order it's all right.

Mr. Rosenbloom: May I have just a minute, please?

The Court: Yes.

Mr. Rosenbloom: Will it be an order without an opinion, Your Honor?

The Court: Yes.

Mr. Rosenbloom: Yes, I'd prefer an order.

The Court: I think then, Mr. Salkin, and you, Mr. Fuerth, go upstairs and get an order to me, say, no later than three o'clock this afternoon. Read it to Mr. Rosenbloom before you submit it to me.

I think that you understand clearly now, that two people may see these books between ten and eleven o'clock next Monday morning, one of whom will be Mr. Tiberino.

(27)

Mr. Fuerth: Yes, sir.

The Court: And the other of whom will be——

Mr. Fuerth: Mr. Coleman Raines.

The Court: You can give that to me three o'clock this afternoon. I don't know how many books this corporation has. I am not limiting it to purchases books.

They may look over the books between ten and eleven next Monday morning.

Mr. Salkin: That will be June 10th?

Mr. Rosenbloom: Yes.

The Court: Yes, that will be June 10th.

Mr. Fuerth: That will be at 4100 Frankford Avenue?

Mr. Rosenbloom: Yes.

Thank you, Your Honor.

Mr. Fuerth: Thank you, Your Honor.

(Hearing Adjourned.)

ORDER.

This case having come on for hearing this date, the Pleadings and Attachments thereto having been considered and argument by the respective counsel having been heard, it is hereby

ORDERED

that Max Powell, President of William Penn Laundry, Inc., produce for examination by Special Agent Ernest J. Tiberino, Jr., and Revenue Agent Coleman Raines, at 4100 Frankford Ave., Philadelphia, Pennsylvania, on June 10, 1963, from 10:00 o'clock, A. M., to 11:00 o'clock, A. M., the following books, records and papers, of William Penn Laundry, Inc., for its fiscal years ending July 31, 1958 and July 31, 1959:

Minute books
Stock certificate books
General ledgers
General journals
Purchase journals and cash disbursement journals
Sales journal and cash receipts journals
and all subsidiary records kept to substantiate the entries in the above-mentioned records.

/s/ ALLAN K. GRIM,
J.
United States District Court for the Eastern District of Pennsylvania

Dated: June 5, 1963.

NOTICE OF APPEAL.

Please take notice that William Penn Laundry, Inc. and Max Powell, respondents above named, hereby appeal to the Court of Appeals for the Third Circuit from the order of June 5, 1963, in the above captioned proceeding.

FRED L. ROSENBLOOM,
Fred L. Rosenbloom,
1719 Packard Building,
Philadelphia 2, Pennsylvania,
Attorney for Appellants Max Powell and William Penn Laundry, Inc.

June 7, 1963

ORDER.

Upon consideration of the stipulation of the parties filed of record this date, it is hereby

ORDERED

that compliance with the Order of this Court entered June 5, 1963, is postponed pending the appeal in this action pursuant to the terms of said stipulation.

VAN DUSEN, J.

Dated: June 8, 1963.

for William K. Drum, Jr.
Approved by Judge Drum in a phone conversation at 10:20 AM on this date.

STIPULATION.

IT IS HEREBY AGREED by the parties to consent to a stay of the order dated June 5, 1963, pending an appeal of the above captioned action on the condition that in the event the Government prevails in the appeal then the Respondents agree to produce for examination within ten (10) days after the receipt in the District Court of the mandate finally disposing of the appeal in this action, those books and records called for in the Internal Revenue Summons of March 13, 1963, which is the subject of this action, for as long a period of time as is reasonably necessary for the conduct of a proper examination.

IT IS FURTHER AGREED that in the event the appeal is dismissed the scope of the present order shall be expanded so as not to be limited to examination of one hour's duration but rather for as long a period of time as is reasonably necessary for the conduct of a proper examination of said books and records. Respondents reserve the right to resist the order as broadened if necessary to perfect their appeal.

/s/ DREW J. T. O'KEEFE,
Drew J. T. O'Keefe,
United States Attorney,

/s/ SIDNEY SALKIN,
Sidney Salkin,
Assistant United States Attorney,
Attorneys for Petitioners.

/s/ FRED L. ROSENBLOOM,
Fred L. Rosenbloom, Esq.,
Attorney for Respondents.

48 In the United States Court of Appeals for the Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued October 17, 1963

Before: MCLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

Opinion of the Court—Filed December 23, 1963

By HASTIE, *Circuit Judge.*

The United States and a special agent of the Internal Revenue Service brought this action in the district court, as authorized by section 7604(b) of the 1954 Internal Revenue Code, to compel a corporate taxpayer, William Penn Laundry, Inc., and its president, Max Powell, to obey an administrative summons, issued in March 1963 by special agent Ernest Tiberino, one of the plaintiffs, directing them to appear
49 before him and to produce for reexamination certain records of the corporation for the years 1958 and 1959.

In response to the summons, Powell appeared before Tiberino at a formal hearing and pointed out that the taxpayer's records for 1958 and 1959 had already been examined, that the normal three-year statute of limitations had run against 1958 and 1959 deficiency assessments, that only to redress fraud could those closed years be reopened and that he knew of no basis upon which fraud could be

784-867—64

attributed to the taxpayer. He then asked agent Tiberino to indicate some justification for reexamining the records in question and refused to produce them otherwise. Tiberino declined to justify his demand and summarily terminated the hearing. He then instituted this enforcement proceeding.

With this petition Tiberino filed in the district court his affidavit asserting that "on the basis of information obtained" in a current investigation of taxpayer's 1958 and 1959 income tax returns, "he has reason to suspect that the William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958 and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years". Answering the petition, the defendants stated what had occurred at the hearing before agent Tiberino and again refused to produce the 1958 and 1959 records unless justification for their reexamination should be shown. When the matter came on for hearing, the plaintiffs elected to make no factual showing beyond Tiberino's affidavit. Indeed, Tiberino was not present, appearing only by counsel. After hearing arguments, the court ordered the defendants to honor the summons and produce their records for Tiberino's examination. The defendants have appealed from that order.

50 We first summarize the relevant provisions of the 1954 Internal Revenue Code. Section 7602 confers upon the Secretary of the Treasury or his delegate very broad power to summon witnesses and to require the production of records "as may be relevant or material" to inquiry into tax liability. Section 7605(b) prohibits subjecting a taxpayer "to unnecessary examination or investigations". Section 7604(b) provides that the judge who is asked to enforce an administrative summons shall hear the application and, "if satisfactory proof is made", take coercive action against the person summoned.

On this appeal we must determine in the light of the above cited provisions of the statute what a court's responsibility is when it is asked to enforce an administrative demand to reexamine a taxpayer's records after a return has been filed for the year in question, the taxpayer's supporting records have

been examined, the tax has been paid in accordance with the indicated liability, and the normal three-year statute of limitations [1] has run against any further deficiency assessment. In such circumstances, the imposition of any additional liability upon the taxpayer must be predicated upon fraud. 26 U.S.C. § 6501(c) (1). Logically, therefore, a reexamination of his records must be "unnecessary" within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year. *Cf. Farmers' & Mechanics' Nat. Bk. v. United States*, 3d Cir. 1926, 11 F. 2d 348; *In re Andrews' Tax Liability*, D.Md. 1937, 18 F. Supp. 804. Nevertheless, the government insists that the basis of the Treasury agent's suspicion is not a matter of judicial cognizance. Rather, it is argued, the agent is entitled to judicial enforcement of his demand for the tax-
51 payer's records if he merely submits to the court his affidavit asserting in generality that "he has reason to suspect" that there has been fraud in the taxpayer's computation of his tax for the year in question. In the government's view the agent need not even set out in his affidavit the facts which gave him "reason to suspect" fraud, much less establish by testimony in court that his suspicion is reasonably grounded. This also seems to be the view of the Court of Appeals for the Second Circuit. *Foster v. United States*, 2d Cir. 1959, 265 F. 2d 183, *cert. denied*, 360 U.S. 912.

Rejecting this view, we consider it significant that section 7604(b) requires a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made. We think this provision means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. *O'Connor v. O'Connell*, 1st Cir. 1958, 253 F. 2d 365, followed in *Lash v. Niahosian*, 1st Cir. 1959, 273 F. 2d 185, *cert. denied*, 1960, 362 U.S. 904; *United States v. Carey*, D.Del. 1963, 218 F. Supp. 298. This the court cannot do unless the agent discloses whatever may have created

[1] There is no suggestion here that the six-year statute of limitations applicable to gross understatement of income may be applicable. 26 U.S.C. § 6501(e)(1).

If facts are alleged in the petition or in a supporting affidavit as the basis of the agent's suspicion and are not denied in a responsive pleading there may be no need to take testimony. Otherwise, the agent must present evidence showing some rational basis for his suspicion.

his suspicion. Since the agent in this case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied.

Our conclusion is in accord with the ruling of the Court of Appeals for the First Circuit in *O'Connor v. O'Connell, supra*, and contrary to the language of the Court of Appeals for the Second circuit in *Foster v. United States, supra*. The government also contends that very recent decisions in the Sixth and Ninth Circuits grant the government relief in cases like this one. We do not read those decisions that way.

52 *United States v. Ryan*, 6th Cir. 1963, 320 F. 2d 500, does contain language suggesting that a court, asked to enforce an internal revenue summons, need not inquire into the reasonableness of administrative suspicion of fraud. However, the opinion shows that the petitioning revenue agent testified in the enforcement proceeding and explained the basis of his apprehension concerning fraud. Moreover, the decisive conclusion of the court of appeals was that "the district court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary".

The Court of Appeals for the Ninth Circuit dealt with this problem in *De Masters v. Arend*, 1963, 313 F. 2d 79. There again the petitioning agent testified as to the basis of his suspicion. He had found that deposits in the bank account maintained for the taxpayer's store were substantially greater than the total gross receipts of the business as reported in the taxpayer's income tax return. Moreover, a preliminary computation had indicated an increase in the taxpayer's net worth which far exceeded his reported income. With this testimony before it, the court said that "if it appeared that the decision to investigate * * * [possible fraud] was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation could not be an 'unnecessary' one prohibited by Section 7605(b), just as the act of issuing an administrative subpoena in such circumstances would not be 'arbitrary' and the subpoena unenforceable." 313 F. 2d at 90. The court concluded that the "showing by the taxpayers in the present case that further assessment was time-barred in the absence of fraud may have been sufficient to require the appellants to go forward with a justification of

their inquiry. But this they did, and the showing which they made was sufficient to establish (1) that further investigation was undertaken pursuant to the Commissioner's author-
53 ity, and (2) that the decision to proceed was not arbitrary." 313 F. 2d at 91. This is essentially the position that we take in this case.[3]

The judgment will be reversed.

54 In the United States Court of Appeals for the Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE

vs.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: McLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

Judgment—December 23, 1963

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court filed June 5, 1963 be, and the same is hereby reversed.

[File Endorsement Omitted]

DECEMBER 23, 1963.

[3] Probably the Sixth and Ninth Circuits would sustain administrative judgment as to the need for reexamination of records of closed years upon a less impressive showing of suspicious circumstances than the First Circuit would require. However this is a matter of quantum of proof which does not concern us here because of showing whatever has been made as to the basis of the special agent's suspicion.

55 In the United States Court of Appeals for the Third Circuit

No. 14516

[Title Omitted]

Order Staying Issuance of Mandate—February 5, 1964

Pursuant to Rule 36 (2) of this Court, it is ORDERED that issuance of the mandate in the above cause be, and it is hereby stayed until March 2, 1964.

WILLIAM H. HASTIE
Circuit Judge.

FEBRUARY 5, 1964.

[File Endorsement Omitted]

56 [Clerk's Certificate to foregoing transcript omitted in printing.]

57 Supreme Court of the United States

OCTOBER TERM, 1963

No. 944

UNITED STATES, ET AL., PETITIONER

vs.

MAX POWELL, ET AL.

Order Allowing Certiorari. May 18, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted. The case is placed on the summary calendar and set for oral argument immediately following No. 590

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. —

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE, PETITIONERS

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of the United States and Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit reversing an order of the district court which directed respondent Powell to comply with an Internal Revenue summons.

OPINION BELOW

The opinion of the court of appeals (Appendix, *infra*, pp. 15–20) is reported at 325 F. 2d 914.

JURISDICTION

The judgment of the court of appeals (App. *infra*, p. 21) was entered on December 23, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the Internal Revenue Service, in order to enforce a summons for the production of books and records relating to closed tax years as to which additional taxes may be assessed only in case of fraud, is required to show probable cause for believing that there is fraud.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * * * *

(c) *Exceptions.*—

(1) *False return.*—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) *Willful attempt to evade tax.*—In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 6501.)

SEC. 7601. CANVASS OF DISTRICTS FOR TAXABLE PERSONS AND OBJECTS.

(a) *General Rule.*—The Secretary or his delegate shall, to the extent he deems it practicable, cause officers or employees of the Treas-

ury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

* * * * *

(26 U.S.C. 7601.)

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under

oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(26 U.S.C. 7602.)

SEC. 7604. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87 and Sec. 208 (d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374]. ENFORCEMENT OF SUMMONS.

(a) *Jurisdiction of District Court.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides, or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) *Enforcement.*—Whenever any person summoned under section 6420(e)(2), 6421(f)(2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required. the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or

the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

* * * * *

(26 U.S.C. 7604.)

SEC. 7605. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87 and Sec. 208 (d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374]. TIME AND PLACE OF EXAMINATION.

(a) *Time and Place.*—The time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(f)(2), or 7602 shall be such time and place as may be fixed by the Secretary or his delegate and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2) or 6421(f)(2), the date fixed for appearance before the Secretary or his delegate shall not be less than 10 days from the date of the summons.

(b) *Restrictions on Examination of Taxpayer.*—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

(26 U.S.C. 7605.)

STATEMENT

On March 12, 1963, the Internal Revenue Service issued a summons directing respondent Powell, the president of respondent William Penn Laundry, Inc. ("the taxpayer"), to appear before petitioner Tiberino, a Special Agent of the Service, and to give testimony and produce specified books and records of the taxpayer relating to the latter's tax liability for the fiscal years ending July 31, 1958 and 1959 (R. 10a–11a).[1] Powell appeared before Tiberino, but upon advice of counsel declined to produce the records (R. 14a–16a). He contended that since the statute of limitations barred assessment of any additional taxes for those years except in case of fraud, and that since those years had been previously examined, "unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years" (R. 16a–17a). He told Agent Tiberino that "If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position" (R. 17a). Tiberino replied that "in view of the position taken today, there is no point in carrying this meeting any further at this time" (*ibid.*).

On May 20, 1963, the government instituted a proceeding in the District Court for the Eastern District

[1] "R." refers to the appellant's appendix in the court of appeals, which has been filed with the Clerk.

Prior to the issuance of the summons, the Regional Commissioner of the Service had informed the taxpayer by letter that, "in order properly to verify its returns for those years," a reexamination of its books and records would be made (R. 9a).

of Pennsylvania, pursuant to Section 7604(b) of the Internal Revenue Code of 1954, to enforce the summons (R. 1a, 3a–5a). Attached to the petition for enforcement was an affidavit by Tiberino stating that since February, 1963, he had been investigating the correctness of taxpayer's income tax returns for 1958 and 1959; that on the basis of information obtained in the investigation "he has reason to suspect" that the taxpayer filed false and fraudulent returns for those years with intent to evade its taxes and had attempted to evade such taxes for those years "by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income" for those years; and that, "based upon the above investigation," the Regional Commissioner of the Internal Revenue Service "determined that an additional examination" of the taxpayer's books and records for those years "was necessary" (R. 7a–8a).

In response to the petition, the respondents reiterated their argument that since the assessment of any additional tax for those years was barred by the statute of limitations unless there was fraud, the government was not entitled to examine the books and records for those years unless it offered "some justification for attempting to open the closed years in question," and that although Agent Tiberino had been requested to give some justification, he had declined to do so (R. 22a–24a).

After hearing argument, the district court held that the allegation in Tiberino's affidavit that the

785-870—64—2

taxpayer had overstated the amount of its purchases which were treated as expenses was sufficient to warrant a further investigation (R. 40a–41a) and, with certain limitations not here pertinent, enforced the summons (R. 45a).

The court of appeals reversed. It held that, in view of the prohibition in Section 7605(b) of the Code against subjecting taxpayers to "unnecessary examination or investigations," a reexamination of a taxpayer's records for years as to which the assessment of additional taxes is barred by the statute of limitations except in case of fraud "must be 'unnecessary' within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year" (App. *infra*, p. 18). Rejecting the view of the Second Circuit in *Foster* v. *United States*, 265 F. 2d 183, certiorari denied, 360 U.S. 912, that the government need not establish probable cause that the taxpayer had committed fraud during the closed years, the court stated (*id.*, pp. 18–19) that the requirement in Section 7604(b) of the Code that there be

> a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made * * * means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. * * * This the court cannot do unless the agent discloses whatever may have created his suspicion. Since the agent in this

case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied [footnote omitted].

REASONS FOR GRANTING THE WRIT

1. The holding of the court below that the Internal Revenue Service cannot enforce a summons for the production of records relating to closed taxable years unless it establishes that the "agent's suspicion of fraud is reasonable" i., as the court itself recognized, in direct conflict with *Foster* v. *United States*, 265 F. 2d 183 (C.A. 2), certiorari denied, 360 U.S. 912. In *Foster* the Second Circuit affirmed a district court order enforcing such a summons, which rested upon an agent's affidavit which did not even state (unlike the affidavit in the present case) that he had "reason to suspect" tax evasion for the closed years. The affidavit in *Foster* stated only that the records sought were "required to authenticate" certain claims of the taxpayer (265 F. 2d at 186). The court held (pp. 186–187) that since the allegations in the affidavit "showed that the inspection sought was in aid of an investigation properly authorized by Congress by § 7602 of the Internal Revenue Code of 1954" and that "the records sought were material and relevant to the investigation," the enforcement order was proper; "an affirmative showing of probable cause for the administrative inquiry is not required. * * * [T]he Commissioner, as a condition to the issuance of a summons and order under §§ 7602 and 7604, should not be required to prove grounds for belief that [because of fraud] the liability was not time-barred 'prior to ex-

amination of the only records which provide the ultimate proof.'"

The decision below also conflicts with *United States* v. *Ryan*, 320 F. 2d 500 (C.A. 6), certiorari granted, February 17, 1964, No. 590, this Term. In *Ryan* the court of appeals, in affirming the district court's enforcement order, rejected the taxpayer's contention (320 F. 2d at 501) that "to entitle the government to enforcement of summons with respect to the barred years, it 'must establish to the satisfaction of the District Court that a reasonable basis exists for his suspicion of fraud or that probable cause exists to believe the taxpayer was guilty of fraud.'" The court pointed out (p. 502) that the Code "confer[s] broad investigative powers on the Secretary to aid him in the performance of his statutory duties and provide[s] a summary procedure in court to enforce compliance with the summons. Nowhere has Congress required the Secretary to establish, as a condition precedent to the exercise of his right to investigate, that he have a reasonable basis therefor or probable cause to suspect criminality." The court cited *Foster, supra*, as a case "not requiring the establishment of probable cause as a condition precedent to a tax investigation" (p. 503).

By granting certiorari in *Ryan*,[2] this Court recognized the need for resolution of the conflict among

[2] Although the government originally had opposed review in *Ryan*, it withdrew its opposition as a result of the decision in the present case. See the Brief in Opposition and the Supplemental Memorandum, No. 590, this Term.

the circuits[1] over this important question in the administration of the revenue laws. In deciding the issue, the Court should also have the present case before it. In *Ryan* the agent testified as to his reasons for concluding that the investigation was necessary (320 F. 2d at 501), and the court of appeals ruled (p. 502) that "the District Court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary." This Court might hold in *Ryan* that the agent's testimony fully established the need for the investigation, and therefore find it unnecessary to decide the broader underlying issue whether, in order to enforce a summons relating to closed tax years, the government must show probable cause that the taxpayer committed fraud. In the present case, on the other hand, the court of appeals ruled that the agent's failure to disclose "whatever may have created his suspicion" barred enforcement of the summons (App., *infra*, p. 19). This ruling squarely presents the basic issue whether, as the government contends and as the court of appeals ruled in *Ryan* (320 F. 2d at 502), the district court's function is limited to

[1] The First Circuit is in accord with the court below that the government is required to prove probable cause. *O'Connor* v. *O'Connell*, 253 F. 2d 365, 370; *Lash* v. *Nighosian*, 273 F. 2d 185, certiorari denied, 362 U.S. 904. In addition to the Second (*Foster*) and Sixth (*Ryan*) Circuits, three other circuits also have rejected the probable cause requirement. *Globe Construction Co.* v. *Humphrey*, 229 F. 2d 148 (C.A. 5); *McDermott* v. *John Baumgarth Co.*, 286 F. 2d 864, 867 (C.A. 7); *DeMasters* v. *Arend*, 313 F. 2d 79 (C.A. 9), petition for certiorari dismissed, 375 U.S. 936.

determining "whether the investigation is being made in good faith for one of the purposes authorized by the statute or to reliev[ing] against oppressive procedures." The reasons why we believe that a showing of good cause is not required are set forth at pages 5 to 7 of our brief in opposition in *Ryan* (see note 2, *supra*, p. 10), to which we refer the Court.

2. Even if, contrary to our view, the government is required to show good cause for suspecting that the taxpayer committed fraud, a sufficient showing was made here. The agent stated in his affidavit that, on the basis of "information obtained in" a three-month investigation of the taxpayer's corporate income tax returns for the fiscal years 1958 and 1959, he had reason to suspect that the corporation "has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years" (R. 7a-8a). The taxpayer's suspected overstatement of its purchases, with its consequent inflation of deductible business expenses, was plainly sufficient to justify examination of the taxpayer's books and records for the years in which the alleged overstatement occurred. The agent was not required to state in greater detail the reasons for his conclusion that a further investigation of the taxpayer was appropriate. Any concern about protecting this taxpayer from harassment by an "unnecessary" investigation is thus dissipated by the agent's affidavit, and the district court was fully warranted in enforcing the summons.

CONCLUSION

This petition for a writ of certiorari should be granted, and the case should be set for argument following *Ryan* v. *United States*, No. 590, this Term.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attornel General.
JOSEPH M. HOWARD,
NORMAN SEPENUK,
BURTON BERKLEY,
Attorneys.

MARCH 1964.

APPENDIX

United States Court of Appeals for the Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued October 17, 1963

Before: McLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

OPINION OF THE COURT

(Filed December 23, 1963)

By HASTIE, *Circuit Judge.*

The United States and a special agent of the Internal Revenue Service brought this action in the district court, as authorized by section 7604(b) of the 1954 Internal Revenue Code, to compel a corporate

taxpayer, William Penn Laundry, Inc., and its president Max Powell, to obey an administrative summons, issued in March 1963 by special agent Ernest Tiberino, one of the plaintiffs, directing them to appear before him and to produce for reexamination certain records of the corporation for the years 1958 and 1959.

In response to the summons, Powell appeared before Tiberino at a formal hearing and pointed out that the taxpayer's records for 1958 and 1959 had already been examined, that the normal three-year statute of limitations had run against 1958 and 1959 deficiency assessments, that only to redress fraud could those closed years be reopened and that he knew of no basis upon which fraud could be attributed to the taxpayer. He then asked agent Tiberino to indicate some justification for reexamining the records in question and refused to produce them otherwise. Tiberino declined to justify his demand and summarily terminated the hearing. He then instituted this enforcement proceeding.

With this petition Tiberino filed in the district court his affidavit asserting that "on the basis of information obtained" in a current investigation of taxpayer's 1958 and 1959 income tax returns, "he has reason to suspect that the William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958 and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years". Answering the petition, the defendants stated what had occurred at the hearing before agent Tiberino and

again refused to produce the 1958 and 1959 records unless justification for their reexamination should be shown. When the matter came on for hearing, the plaintiffs elected to make no factual showing beyond Tiberino's affidavit. Indeed, Tiberino was not present, appearing only by counsel. After hearing argument, the court ordered the defendants to honor the summons and produce their records for Tiberino's examination. The defendants have appealed from that order.

We first summarize the relevant provisions of the 1954 Internal Revenue Code. Section 7602 confers upon the Secretary of the Treasury or his delegate very broad power to summon witnesses and to require the production of records "as may be relevant or material" to inquiry into tax liability. Section 7605(b) prohibits subjecting a taxpayer "to unnecessary examination or investigations". Section 7604(b) provides that the judge who is asked to enforce an administrative summons shall hear the application and, "if satisfactory proof is made", take coercive action against the person summoned.

On this appeal we must determine in the light of the above cited provisions of the statute what a court's responsibility is when it is asked to enforce an administrative demand to reexamine a taxpayer's records after a return has been filed for the year in question, the taxpayer's supporting records have been examined, the tax has been paid in accordance with the indicated liability, and the normal three-year statute of limitations [1] has run against any further deficiency assessment. In such circumstances, the imposition of any additional liability upon the taxpayer must be predi-

[1] There is no suggestion here that the six-year statute of limitations, applicable to gross understatement of income, may be applicable. 26 U.S.C. § 6501(e)(1).

cated upon fraud. 26 U.S.C. § 6501(c)(1). Logically, therefore, a reexamination of his records must be "unnecessary" within the meaning of section 7605 (b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year. *Cf. Farmers' & Mechanics' Nat. Bk.* v. *United States*, 3d Cir. 1926, 11 F. 2d 348; *In re Andrews' Tax Liability*, D. Md. 1937, 18 F. Supp. 804. Nevertheless, the government insists that the basis of the Treasury agent's suspicion is not a matter of judicial cognizance. Rather, it is argued, the agent is entitled to judicial enforcement of his demand for the taxpayer's records if he merely submits to the court his affidavit asserting in generality that "he has reason to suspect" that there has been fraud in the taxpayer's computation of his tax for the year in question. In the government's view the agent need not even set out in his affidavit the facts which gave him "reason to suspect" fraud, much less establish by testimony in court that his suspicion is reasonably grounded. This also seems to be the view of the Court of Appeals for the Second Circuit. *Foster* v. *United States*, 2d Cir. 1959, 265 F. 2d 183, *cert. denied*, 360 U.S. 912.

Rejecting this view, we consider it significant that section 7604(b) requires a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made. We think this provision means that the court shall decide on the basis of the showing made in the normal course[2] of

[2] If facts are alleged in the petition or in a supporting affidavit as the basis of the agent's suspicion and are not denied in a responsive pleading there may be no need to take testimony. Otherwise, the agent must present evidence showing some rational basis for his suspicion.

an adversary proceeding whether the agent's suspicion of fraud is reasonable. *O'Connor* v. *O'Connell*, 1st Cir. 1958, 253 F. 2d 365, followed in *Lash* v. *Niqhosian*, 1st Cir. 1959, 273 F. 2d 185, *cert. denied*, 1960, 362 U.S. 904; *United States* v. *Carey*, D. Del. 1963, 218 F. Supp. 298. This the court cannot do unless the agent discloses whatever may have created his suspicion. Since the agent in this case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied.

Our conclusion is in accord with the ruling of the Court of Appeals for the First Circuit in *O'Connor* v. *O'Connell, supra*, and contrary to the language of the Court of Appeals for the Second Circuit in *Foster* v. *United States, supra*. The government also contends that very recent decisions in the Sixth and Ninth Circuits grant the government relief in cases like this one. We do not read those decisions that way.

United States v. *Ryan*, 6th Cir. 1963, 320 F. 2d 500, does contain language suggesting that a court, asked to enforce an internal revenue summons, need not inquire into the reasonableness of administrative suspicion of fraud. However, the opinion shows that the petitioning revenue agent testified in the enforcement proceeding and explained the basis of his apprehension concerning fraud. Moreover, the decisive conclusion of the court of appeals was that "the district court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary".

The Court of Appeals for the Ninth Circuit dealt with this problem in *De Masters* v. *Arend*, 1963, 313 F. 2d 79. There again the petitioning agent testified as to the basis of his suspicion. He had found that deposits in the bank account maintained for the tax-

payer's store were substantially greater than the total gross receipts of the business as reported in the taxpayer's income tax return. Moreover, a preliminary computation had indicated an increase in the taxpayer's net worth which far exceeded his reported income. With this testimony before it, the court said that "if it appeared that the decision to investigate * * * [possible fraud] was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation could not be an 'unnecessary' one prohibited by Section 7605(b), just as the act of issuing an administrative subpoena in such circumstances would not be 'arbitrary' and the subpoena unenforceable." 313 F. 2d at 90. The court concluded that the "showing by the taxpayers in the present case that further assessment was time-barred in the absence of fraud may have been sufficient to require the appellants to go forward with a justification of their inquiry. But this they did, and the showing which they made was sufficient to establish (1) that further investigation was undertaken pursuant to the Commissioner's authority, and (2) that the decision to proceed was not arbitrary." 313 F. 2d at 91. This is essentially the position that we take in this case.[3]

The judgment will be reversed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

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[3] Probably the Sixth and Ninth Circuits would sustain administrative judgment as to the need for reexamination of records of closed years upon a less impressive showing of suspicious circumstances than the First Circuit would require. However, this is a matter of quantum of proof which does not concern us here because no showing whatever has been made as to the basis of the special agent's suspicion.

In the United States Court of Appeals for the Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: McLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court filed June 5, 1963 be, and the same is hereby reversed.

ATTEST:

IDA O. CRESKOFF, *Clerk.*

Received and filed December 23, 1963.

IDA O. CRESKOFF, *Clerk.*

DECEMBER 23, 1963.

U. S. GOVERNMENT PRINTING OFFICE: 1964

IN THE

Supreme Court of the United States

October Term, 1961

No. 54

UNITED STATES OF AMERICA and ERNEST J. TIBERINO, JR., Special Agent, Internal Revenue Service,
Petitioners,

v.

MAX POWELL and WILLIAM PENN LAUNDRY, INC.

On Petition for a Writ of Certiora... to the United States Court of Appeals for the Third Circuit.

MEMORANDUM ON BEHALF OF RESPONDENTS.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1963.

No. 944.

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE,

Petitioners

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

MEMORANDUM ON BEHALF OF RESPONDENTS.

In this case, the Internal Revenue Service has advanced for decision a claim of statutory power which the Service has frequently asserted but has rarely placed squarely in issue. Specifically, the Internal Revenue Service asserts that, by virtue of the broad language of Section 7602 of the Internal Revenue Code of 1954, 26 U. S. C. 7602, it possesses unlimited power to compel the production of a taxpayer's books and records and to require the giving of testimony in response to administrative summons. Where the administrative demand is resisted, it is the posi-

tion of the Service that it can obtain judicial enforcement of its demand on the basis of its bare statement to the enforcing court that the Service has determined the demand to be reasonable and necessary.

Here, an administrative demand was made for the production of all of respondent's books and records for its tax years 1958 and 1959 (R. 23a). Respondent's returns for those years had been timely filed and had been earlier examined by Internal Revenue Service Agents who had assessed deficiencies which were promptly paid (R. 22a-23a). The demand for production of respondent's books and records was first made on February 26, 1963, more than three years after the returns for 1958 and 1959 had been filed (R. 23a).

At an administrative hearing held on March 25, 1963, the Special Agent, who had caused the summons to be issued and who conducted the hearing, declined to offer any justification for the decision to re-examine the years in question (R. 23a-24a, 17a). This position, that no justification would or need be advanced for the decision by the Service to re-examine respondent's books and records for these closed years, was deliberately adhered to by the Service in the proceeding which it brought in the District Court for the Eastern District of Pennsylvania to compel compliance with the summons (R. 3a-5a). The pleading whereby the compliance proceeding was instituted rested on the issuance of the summons and the refusal of respondent to comply, and demanded an order directing such compliance. Attached to the pleading was an affidavit by the Special Agent which contained, *inter alia*, a conclusory statement as to his suspicion of fraud. In the district court proceeding, counsel for the Internal Revenue Service declined to offer testimony or proof in support of the administrative demand (R. 31a-32a).

The district court expressed dissatisfaction with the refusal of the Service to present testimony (R. 31a-32a, 36a), and stated agreement with respondent's position (R.

37a-38a). However, the district judge determined upon a compromise order whereby he permitted examination of respondent's books and records for one hour only (R. 45a).[1]

From the outset, respondent has challenged the Service's claim to an unlimited right of access to its books and records. Respondent bases its position on Sections 6501, 7605 and 7604 of the Internal Revenue Code. Section 6501 limits the power of the Service to assess and collect taxes to a period of three years after the filing of the return in question, unless fraud or a willful attempt to evade taxes can be shown. Section 7605 provides that no taxpayer shall be subjected to "* * * unnecessary examination or investigations * * *". Section 7604(b) provides for judicial enforcement of an Internal Revenue summons "* * * if satisfactory proof is made * * *" in support of the application for enforcement.

Based on these statutory provisions, respondent requested, at the administrative hearing, that some justification be advanced by the Service for the demanded reexamination and stated that if some justification were offered, respondent would reconsider its position (R. 16a-17a). Respondent's position, of course, was that Section 7602, upon which the Service relied, must be read in the light of these other pertinent sections of the Internal Revenue Code. As already noted, the Service advertently declined to offer any support for its demand either at the administrative level or in the district court proceeding.

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1. The petition for certiorari in this case refers to the curious order of the district court as containing "* * * certain limitations not here pertinent * * *" (Pet., p. 6). The district court order, limiting examination to one hour, was stayed in connection with the appeal and the parties stipulated that, if respondent were not successful on appeal, the Service would not be held to the one hour limitation. We have, however, described the district court's action specifically since elsewhere the petition for certiorari states that "* * * the district court was fully warranted in enforcing the summons" (Pet., p. 12). The transcript shows that the district judge really avoided resolution of the issue presented (R. 34a, 37a-39a).

On appeal, respondent's position was sustained by the Court of Appeals for the Third Circuit in an opinion by Judge Hastie which, we respectfully submit, construes the pertinent statutory provisions correctly. Judge Hastie took as his point of departure the question of a court's responsibility when called upon to enforce a demand by Internal Revenue such as that here involved. On the basis of Section 7604(b), which requires a "hearing" on the application to enforce the administrative summons and the production of "satisfactory proof" at that hearing, Judge Hastie rejected the argument of the Service that the basis for a Special Agent's suspicion of fraud was not a matter of judicial cognizance.[2] Absent the discovery by the Service of some facts which would cause a reasonable man to suspect fraud in a return for an otherwise closed year, and a disclosure of these facts, Judge Hastie held that a reexamination of a taxpayer's records, such as that demanded in this case, was "unnecessary" within the meaning of Section 7605(b) and that enforcement of the administrative summons must be denied.

In reaching its conclusion the court below correctly recognized that, on careful analysis, there is no real conflict among the decisions. An analysis of **United States v. Ryan**, 320 F. 2d 500 (C. A. 6, 1963), in which this Court has granted certiorari (this Term, No. 590), illustrates the point. The **Ryan** opinion, which contains broad language as to the nature of Internal Revenue's power to investigate, was rendered on the basis of a record which plainly shows that, in the district court, an Internal Revenue Agent had testified at length in support of the administrative demand for access to books and records for closed years. In fact, the Court of Appeals for the Sixth Circuit specifically noted

2. That the ultimate thrust of the Service's argument is to reduce the role of the court to that "* * * of summarily affixing its stamp of approval to administrative action * * *" is also discussed in **O'Connor v. O'Connell**, 253 F. 2d 365, 370 (C. A. 1, 1958 and **Lash v. Nighosian**, 273 F. 2d 185, 189 (C. A. 1, 1959), *cert. den.* 362 U. S. 904 (1960).

in the **Ryan** case that the district court had been "* * * justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary" (320 F. 2d at p. 502).[3]

It is on the basis of an asserted conflict between **Ryan** and the decision of the court below in this case that the Solicitor General withdrew his opposition to the petition for certiorari in **Ryan** and acquiesced in the grant of the writ. However, as we have shown, the actual issue presented for decision in each case was entirely different. In **Ryan**, extensive testimony was presented. Here, far from adducing testimony in support of its demand, the Service has contended at all levels that it need make no showing and that its determination—that the production of records

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3. In its brief in opposition in the **Ryan** case (Br. in Opp., pp. 4-5), the Internal Revenue Service states broadly that its position has been accepted "* * * by all other courts of appeals which have had occasion to consider the question. * * *". The same contention is advanced in the petition for certiorari filed in this case (Pet., p. 11, fn. 3). On each occasion, the Service cites **Globe Construction Co. v. Humphrey**, 229 F. 2d 148 (C. A. 5, 1956); **McDermott v. John Baumgarth Company**, 286 F. 2d 864 (C. A. 7, 1961); and **DeMasters v. Arend**, 313 F. 2d 79 (C. A. 9, 1963). Each of these cases is in the **Ryan** pattern. Thus, in **McDermott**, the court of appeals specifically held that the Government had made "* * * a sufficient showing * * *" to support the district court order of enforcement. 286 F. 2d at p. 866. In **DeMasters**, the court pointed out that the burden of going forward with a justification for the investigation had been satisfied by the testimony of the Internal Revenue Agent. 313 F. 2d at p. 291. The point on appeal in **Globe** was a contention that the investigation was an unreasonable search and seizure. The opinion does not deal with the issue here presented and the record on file indicates that substantial evidence was produced by the Internal Revenue Agent involved.

The Service does not refer to **Wall v. Mitchell** 287 F. 2d 31 (C. A. 4, 1961) or **Corbin Deposit Bank v. United States**, 244 F. 2d 177 (C. A. 6, 1957), in both of which decisions the courts of appeals noted that justification for enforcement of the Internal Revenue Summons had been established by the testimony of an Internal Revenue Agent.

or testimony for closed years is necessary—is not a matter for judicial cognizance.

In its petition for certiorari in this case, the Service has particularly emphasized an asserted conflict with the decision of the Court of Appeals for the Second Circuit in **Foster v. United States**, 265 F. 2d 183 (C. A. 2, 1959), *cert. den.*, 364 U. S. 834 (1960).[4] **Foster**, again, contains broad language which seems to accept the position of the Internal Revenue Service as to the sweep of its power to obtain enforcement, and Judge Hastie, for the purpose of the opinion below, accepted the decision on this basis, noting that the decision below was "* * * contrary to the language * * *" in **Foster**. However, no square conflict between the decision of the court below and the view of the Court of Appeals for the Second Circuit can be said to exist. In **Foster**, a substantial showing was made by the Internal Revenue Agent in support of his summons. And in a subsequent decision, the Court of Appeals for the Second Circuit has seemingly retreated from the over-broad language of **Foster**. See **Application of Magnus**, 299 F. 2d 335, 337 (C. A. 2, 1962), *cert. den.*, 370 U. S. 918.

In view of what we have set forth above, it is clear, we submit, that Judge Hastie's decision is plainly correct and

4. The petition for certiorari also refers this Court's attention to pages 5-7 of the brief in opposition in the **Ryan** case and the authorities there cited. The authorities thus referred to consist, in addition to those discussed above, of the decisions of this Court in **United States v. Morton Salt Co.**, 338 U. S. 632 (1950), **Oklahoma Press Publishing Co. v. Walling**, 327 U. S. 186 (1946), and **Endicott Johnson Corp. v. Perkins**, 317 U. S. 501 (1943). These decisions, which deal with constitutional attacks upon the delegation by Congress of broad investigative powers to administrative agencies, are of no relevance here. In such cases, this Court has always adjudged the constitutional issue on the premise that the administrative investigation was within the statutory authority of the agency. Here, the scope of the Service's statutory authority is the very question at issue. Thus, in **Oklahoma v. Walling**, this Court specifically noted that the administrative official could not "* * * act arbitrarily or in excess of his statutory authority * * *" and that administrative actions were subject to judicial supervision in this respect. 327 U. S. at pp. 216-217.

careful examination discloses that the cases are not actually in conflict. The apparent difference has stemmed from efforts by the Internal Revenue Service to develop, by decision rather than by legislation, a rule of administrative convenience, namely, that no showing whatever need be made to support a demand by Internal Revenue Service for the production of books and records or the giving of testimony. The Service has done this, as in the **Ryan** case, by contending for a broad rule while, at the same time, actually [illegible]enting testimony in support of its demand. Only in the instant case has the Service actually placed its interpretation of the statute at risk by deliberately refusing, both at the administrative and at the court levels, to advance any specific reason to justify enforcement of its summons.

On the assumption that the assertion by the Solicitor General of a conflict between this case and the **Ryan** case formed at least one ingredient in this Court's determination to grant a writ in **Ryan**, respondent here has determined not to file a formal brief in opposition. However, respondent here asserts and would assert in presenting its case, that Judge Hastie's decision is entirely correct and that there is, in fact, no actual conflict of decision among the circuits. If, nevertheless, the Court is of the opinion that this case is to be reviewed, we respectfully request that the case be set down for argument with the **Ryan** case since, as the Government has urged in its petition for certiorari herein, the basic issue as to the power of the Internal Revenue Service is more squarely presented by the record in this case.

Respectfully submitted,

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CITATIONS

742-226—64——1

In the Supreme Court of the United States

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No. 54

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE, PETITIONERS

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONERS

OPINION BELOW

The opinion of the court of appeals (R. 49–53) is reported at 325 F. 2d 914.

JURISDICTION

The judgment of the court of appeals was entered on December 23, 1963 (R. 53). The petition for a writ of certiorari was filed on March 23, 1964, and was granted on May 18, 1964 (R. 54; 377 U.S. 929). The jurisdiction of this Court rests on 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the Internal Revenue Service, in order to enforce a summons for the production of books and records relating to years as to which additional taxes may be still assessed in case of fraud, is required to show probable cause for believing that there was fraud.

STATUTES INVOLVED

Sections 6001, 6201, 6501, 7402, 7601, 7602, 7604, and 7605 of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*.

STATEMENT

On March 12, 1963, the Internal Revenue Service issued a summons directing respondent Powell, the president of respondent William Penn Laundry, Inc. ("the taxpayer"), to appear before petitioner Tiberino, a Special Agent of the Service, and to give testimony and produce specified books and records of the taxpayer relating to the latter's tax liability for the fiscal years ending July 31, 1958 and 1959 (R. 10a–11a).[1] Powell appeared before Tiberino, but upon advice of counsel declined to produce the records (R. 14a–16a). Noting that the statute of limitations barred assessment of any additional taxes for those years except in case of fraud, and that the records for those years had been previously examined, Powell

[1] Prior to the issuance of the summons, the Regional Commissioner of the Service had informed the taxpayer by letter that, "in order to properly verify its returns for those years," it was deemed necessary to make a reexamination of its books and records (R. 9a).

contended that "unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years" (R. 16a–17a). He told Agent Tiberino that "If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position" (R. 17a). Tiberino replied that "in view of the position taken today, there is no point in carrying this meeting any further at this time" (*ibid.*).

On May 20, 1963, the government instituted a proceeding in the District Court for the Eastern District of Pennsylvania to enforce the summons (R. 1a, 3a–5a). Attached to the petition for enforcement was an affidavit by Tiberino stating that, since February, 1963, he had been investigating the correctness of taxpayer's income tax returns for 1958 and 1959; that, on the basis of information obtained in the investigation, "he has reason to suspect" that the taxpayer filed false and fraudulent returns for those years with intent to evade its taxes and had attempted to evade such taxes "by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income;" and that, "based upon the above investigation," the Regional Commissioner of the Internal Revenue Service "determined that an additional examination" of the taxpayer's books and records for those years "was necessary" (R. 7a–8a).

In response to the petition, the respondents reiter-

ated their argument that, since the assessment of any additional tax for those years was barred by the statute of limitations unless there was fraud, the government was not entitled to examine the books and records for those years unless it offered "some justification for attempting to open the closed years in question," and that, although Agent Tiberino had been requested to give some justification, he had declined to do so (R. 22a–24a).

After hearing argument, the district court held that the allegation in Tiberino's affidavit that the taxpayer had overstated the amount of its purchases which were treated as expenses was sufficient to warrant a further investigation (R. 40a–41a) and, with certain limitations not here pertinent, enforced the summons (R. 45a).

The court of appeals reversed. It held that, in view of the prohibition in Section 7605(b) of the Code against subjecting taxpayers to "unnecessary examination or investigations," a reexamination of a taxpayer's records for years as to which the assessment of additional taxes is barred by the statute of limitations except in case of fraud "must be 'unnecessary' within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year" (R. 50–53). Rejecting the view of the Second Circuit in *Foster* v. *United States*, 265 F. 2d 183, certiorari denied, 360 U.S. 912, that the government need not establish probable cause that the tax-

payer had committed fraud during the closed years, the court stated (R. 51–52) that the requirement in Section 7604(b) of the Code that there be

> a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made * * * means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. * * * This the court cannot do unless the agent discloses whatever may have created his suspicion. Since the agent in this case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied [footnote omitted].

SUMMARY OF ARGUMENT

The holding of the court below—that the Commissioner, as a prerequisite to judicial enforcement of a summons issued in an investigation covering closed tax years, must establish that he has reasonable grounds or probable cause to suspect fraud—seriously interferes with the Commissioner's responsibility to detect frauds on the revenue, is an unwarranted curtailment of his investigatory authority under the Internal Revenue Code, and is not supported by either the language or the legislative history of the pertinent provisions of the Code.

The primary statutory limitation on the Commissioner's investigatory power is that the information sought may be relevant or material to one of the purposes for which he is authorized to make inquiry. One of those purposes is to determine the liability

of any taxpayer for any internal revenue tax, and the corporate books and records sought in the instant summons are obviously pertinent to whether a potential fraud liability exists. The only other statutory restriction is the prohibition in Section 7605(b) of the code against "unnecessary" examinations. The view of the court below—that an examination covering years as to which additional taxes may be assessed only in case of fraud is "unnecessary" within the meaning of this section unless reasonable grounds to suspect fraud are shown—finds no support in either the language or the legislative history of the statute. This provision was designed to protect taxpayers from harassment resulting from repeated but baseless investigations by revenue agents. The statute dealt with this situation by providing that an agent could not make a re-investigation until an authorized Treasury official had examined the case, and determined that the reinvestigation was in fact necessary and not undertaken for purposes of harassment. Here, the requisite determination of necessity was made by the Regional Commissioner, and respondents have made no showing to rebut the presumption of regularity attaching thereto. Moreover, if further proof was needed, the agent's affidavit—disclosing the existence of a potential fraud liability—was plainly sufficient to justify an additional examination, and the district court properly enforced the summons.

ARGUMENT

THE COMMISSIONER IS ENTITLED TO JUDICIAL ENFORCEMENT OF A SUMMONS FOR BOOKS AND RECORDS RELATING TO CLOSED INCOME TAX YEARS UPON A SHOWING THAT THE INFORMATION SOUGHT MAY BE RELEVANT AND MATERIAL TO AN INVESTIGATION TO DETERMINE WHETHER THERE WAS A FRAUDULENT UNDERSTATEMENT OF TAXABLE INCOME

A. INTRODUCTORY

The Commissioner of Internal Revenue has been conducting an investigation to determine whether the respondent corporation filed fraudulent returns for the years 1958 and 1959. Collection of any tax deficiencies for these years is barred by the ordinary 3-year statute of limitations unless the returns are fraudulent, in which case the tax may be assessed and collected at any time (Sec. 6501 (a), (c), Internal Revenue Code of 1954, App. *infra*, p. 24). The court below held that, since "the imposition of any additional liability on the taxpayer must be predicated upon fraud," logic dictated the conclusion that the examination was "unnecessary" within the meaning of Code Section 7605(b) (App. *infra*, p. 27) unless the Commissioner could show that he had reasonable grounds to suspect fraud (R. 51).

This is essentially the view of the First Circuit, which held that the Commissioner "must establish to the district court's satisfaction that a reasonable basis exists for a suspicion of fraud, or put another way, that there is probable cause to believe that the taxpayer was guilty of fraud in a statute barred year." *O'Connor* v.

O'Connell, 253 F. 2d 365, 370; *Lash* v. *Nighosian,* 273 F. 2d 185, certiorari denied, 362 U.S. 904.

This "probable cause" standard has been expressly rejected by the Second, Fifth, Sixth and Ninth Circuits. The Second and Sixth Circuits hold, in substance, that the requirements for judicial enforcement of a summons, with respect to closed years or otherwise, are satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry. *Foster* v. *United States,* 265 F. 2d 183 (C.A. 2), certiorari denied, 360 U.S. 912; *United States* v. *Ryan,* 320 F. 2d 500 (C.A. 6), certiorari granted, 376 U.S. 904, No. 12, this Term. The Fifth Circuit, in a brief opinion, stated that the argument in support of the probable cause standard "proceeds from a misconception of the nature of the subpoena power at issue here and of the conditions requisite to its exercise." *Globe Construction Co.* v. *Humphrey,* 229 F. 2d 148. The Ninth Circuit, while disavowing the probable cause test, takes the view that expiration of the period of limitations is one of the factors to be considered in determining whether the Commissioner has met what it regards as the proper test, *viz.:* "that the decision to investigate in aid of [a statutory] purpose was in fact reached as a matter of rational judgment based on the circumstances of the particular case." *De Masters* v. *Arend,* 313 F. 2d 79, 90, petition for certiorari dismissed, 375 U.S. 936.

The Fourth and Seventh Circuits have found it unnecessary to pass on the question, since the Commissioner's evidence in the cases reaching those courts met

the more stringent test of probable cause. *Wall* v. *Mitchell*, 287 F. 2d 31 (C.A. 4); *McDermott* v. *John Baumgarth Co.*, 286 F. 2d 864 (C.A. 7).

Thus, the issue here is what showing the government must make to obtain judicial enforcement of a summons seeking information with respect to years closed by the statute of limitations except in cases of fraud. We submit (1) that the Internal Revenue Service is entitled to judicial enforcement of a summons covering closed years upon showing that the material sought may be relevant and material to an inquiry which the Commissioner is authorized to make; (2) that the prohibition in Section 7605(b) of the Code against "unnecessary" examinations does not impose any additional requirement of showing probable cause, but was designed merely to protect taxpayers against harassing examinations by unduly zealous agents by requiring that, before a agent could reexamine a taxpayer's records, the Commissioner or his delegated representative (as distinguished from the agent himself) had to be satisfied "after investigation" that such a reexamination was "necessary"; and (3) that the district court properly enforced the summons in the present case since the corporate records sought are relevant and material in determining whether there is fraud, and that there is therefore no basis for any claim that taxpayer is being harassed by an "unnecessary" examination.

B. THE INTERNAL REVENUE CODE GIVES THE COMMISSIONER BROAD INVESTIGATORY POWERS AND HE IS NOT REQUIRED TO SHOW PROBABLE CAUSE TO OBTAIN JUDICIAL ENFORCEMENT OF A SUMMONS

Under the Internal Revenue Code of 1954, the Commissioner of Internal Revenue is "required to make the inquiries" necessary to the determination and assessment of all taxes imposed by the revenue laws (Sec. 6201). He is further specifically directed to "cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax * * *" (Sec. 7601). To supplement these powers of inquiry, the Commissioner is authorized to summon any person to appear and produce books or records and give testimony which "may be relevant or material to" "the purpose of ascertaining the correctness of any return, * * * determining the liability of any person for any internal revenue tax * * *, or collecting any such liability * * *" (Sec. 7602). By the same token, Congress has provided that taxpayers shall keep records under regulations prescribed by the Commissioner (Sec. 6001), and the pertinent regulations require that the records be kept "at all times available for inspection" by revenue agents and retained as long as they may be "material in the administration of any internal revenue law." Treasury Regulations on Income Tax (1954 Code), Sec. 1.6001-1 (a), (e) (26 C.F.R. 1.6001-1 (a), (e)).

To enable the Commissioner to carry out effectively his investigatory duties, federal courts are vested with

jurisdiction to compel compliance with a summons "by appropriate process" (Secs. 7402(b), 7604(a)). The normal procedure, as here, is an application by the Commissioner for an order to show cause why the person summoned should not be ordered to comply. There results "an adversary proceeding affording a judicial determination of the challenges to the summons." *Reisman* v. *Caplin*, 375 U.S. 440, 446. While it is clear that the respondent may attack the administrative subpoena "on any appropriate ground," constitutional or otherwise (*id.*, at 449), there is no hint anywhere that, in a case like this, the Commissioner must establish "probable cause" to believe that the taxpayer is guilty of fraud. Indeed, no such standard is announced even for the extreme case (not here involved) where an order of arrest is sought under Section 7604(b) because the witness has "wholly made default or contumaciously refused to comply." See *Reisman* v. *Caplin*, *supra*, at 448–449. The prerequisite of "satisfactory proof" mentioned there seems plainly directed to the fact of default, not to the validity of the summons, an issue reserved for the subsequent "hearing." *Id.*, at 448. But, in any event, the language of that provision is wholly irrelevant to this case, in which no attachment was requested or needed.[2]

[2] The opinion below (R. 51) erroneously relied on the "satisfactory proof" and "hearing" language of Section 7604(b). This was, at least in part, attributable to the government's mislabelling of its complaint (which, however, did not request arrest of the witness) under that provision (R. 3a). Both errors occurred before this Court's decision in *Reisman* v.

Finally, enforcement of a summons is subject to the restriction that

> No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of the taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary. [Sec. 7605(b).]

In sum, so far as here relevant, judicial enforcement of the Commissioner's summons is subject to three statutory limitations: (1) that the information sought must be for one of the purposes enumerated in Section 7602; (2) that such information "may be relevant or material" to the inquiry (Sec. 7602); and (3) that the examination must not be "unnecessary" (Sec. 7605(b)). Putting aside for a moment this last restriction against "unnecessary" examinations, we note that the requirements of relevance and materiality to a statutory purpose are precisely those which this Court has announced as the governing criteria for judicial enforcement of an administrative summons. Enforcement will be granted upon "the court's determination that the investigation is authorized by Congress, is for a purpose Congress can order, and the documents sought are relevant to the inquiry." *Okla. Press Pub. Co.* v. *Walling*, 327

Caplin, *supra*, made it clear that Section 7604(b) applied only to cases in which arrest was sought because the witness "wholly made default or contumaciously refused to comply." *Id.*, at 448.

U.S. 186, 209; *United States* v. *Morton Salt Co.*, 338 U.S. 632, 652.[3] In so holding, the Court rejected the notion that the administrative agency, as a prerequisite to enforcement of its investigative power, was required under the Fourth Amendment to show "probable cause" to suspect a violation of law (327 U.S. 209–213). As this Court noted in *Morton Salt*, the administrative power of inquisition is "more analagous to the Grand Jury, which does not depend on a case or controversy for power to get evidence, but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not" (338 U.S. at 642–643). Responding to the argument that such a rule would enable an administrative agency to engage in a mere "fishing expedition" to see if it can turn up evidence of guilt, the Court was willing to "assume for the argument that this is so. * * * Even if one were to regard the request for information in this case as caused by nothing more than official curiosity, nevertheless, law-enforcing agencies have a legitimate right to satisfy themselves that corporate behavior is consistent with the law and the public interest" (338 U.S. at 641, 652).

The narrow question remaining is whether Congress intended to impose a requirement of probable cause by the prohibition in Section 7605(b) of the Code against "unnecessary" examinations. As we shall

[3] The Constitution also protects against demands which are too indefinite in breadth. (327 U.S. at 195, 208–209; 338 U.S. at 652.)

now demonstrate, the language of the statute and its legislative history compel a negative answer to this question.

C. SECTION 7605(b) AND ITS LEGISLATIVE HISTORY DO NOT SUPPORT A REQUIREMENT OF PROBABLE CAUSE

In determining what Congress meant by an "unnecessary" examination, the first principle of construction is that "statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them." *DeGanay v. Lederer*, 250 U.S. 376, 381. "Unnecessary" is defined in Webster's New International Dictionary (2d ed. 1949) as "needless, useless or not required under the circumstances." Can the instant investigation—the purpose of which is to determine if respondent corporation filed fraudulent returns—be deemed an "unnecessary" one within the meaning of that definition? The court below answered in the affirmative on the ground that, since "the imposition of any additional liability upon the taxpayer must be predicated upon fraud," the present examination must be "[l]ogically * * * 'unnecessary'" unless there are reasonable grounds to suspect fraud. (R. 51).

We fail to see why this is so. A statute which bars assessment of additional tax deficiencies in the absence of fraud cannot be construed to restrict an investigation to determine if fraud exists. Indeed, since assessment of additional taxes *within* the three year period (whether or not due to fraud) must be predicated upon the existence of a tax deficiency, the court's reasoning would also require the Com-

missioner to establish reasonable grounds to suspect a *deficiency* before proceeding with his investigation. To impose a probable cause requirement in this latter situation would be clearly inconsistent with the Commissioner's broad power to make inquiries of any person who "may be liable" to pay any tax (Sec. 7601), and to investigate for "the purpose of ascertaining the correctness of any return" (Sec. 7602). Yet, if probable cause is not a prerequisite to an investigation within the three year period (as we submit is obviously the case), then how can it be required here? The absence of any statute of limitations means that there is always a potential fraud liability about which to "inquire." *Foster* v. *United States*, 265 F. 2d at 187. And expiration of the normal three year period in no way diminishes the Commissioner's responsibility to determine "the liability of any person for any internal revenue tax" (Sec. 7602), which "surely includes liability which may be assessed on a finding of fraud." *De Masters* v. *Arend*, 313 F. 2d at 89. Therefore, the present fraud investigation falls squarely within the terms of the Commissioner's statutory authorization, and as such can hardly be deemed "unnecessary."

Our conclusion accords with the clearly defined Congressional policy to guard against frauds on the revenue, which is reflected in the imposition of severe criminal and civil penalties[4] and the extraordinary

[4] If *any part* of the deficiency is due to fraud, a civil penalty of 50 percent of the *entire* deficiency is imposed. Sec. 6653(b), Internal Revenue Code of 1954.

provision removing the bar of limitations in the case of civil fraud. Congress has given statutory recognition to the obvious fact that fraud in a return is ordinarily detected and proved only after a most painstaking and time-consuming investigation. Cf. *Colony, Inc.* v. *Commissioner*, 357 U.S. 28, 36.[5] To require a showing of probable cause at precisely the time when the Commissioner most needs his full array of investigative powers would seriously impair his efforts to detect fraudulent returns.[6] As we now show, the pertinent legislative history of Section 7605(b) clearly reveals that Congress never intended

[5] The *Colony* case, *supra*, involved Section 275(c) of the 1939 Code (the predecessor of 1954 Code Section 6501 (e)(1)(A)), which provided a special five-year period of limitations (now six years) where a taxpayer, even though acting in good faith, "omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return * * *." This Court stated that, in enacting this provision, "Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors."

[6] Section 7605(b), by its express terms, indicates that it was designed specifically for the protection of the taxpayer personally. The section would appear to have no application to inquiries made of third parties even though concededly part of an investigation directed solely to the taxpayer's liability. The Second Circuit so holds. *Application of Magnus*, 299 F. 2d 335, certiorari denied, 370 U.S. 918. However, the Ninth Circuit takes a contrary view, *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731, 735-736; cf. *De Masters* v. *Arend*, *supra*, p. 86, fn. 14. To adopt the probable cause test, and further to hold that this rule also applies to examinations of third persons, would make it virtually impossible to bring a fraudulent taxpayer to book.

to impose any probable cause or similar requirement.

Section 7605(b) first appeared as Section 1309 of the Revenue Act of 1921, c. 136, 42 Stat. 227. The purpose of the proposed provision, as stated in the Report of the House Ways and Means Committee, was to meet the complaints of taxpayers "that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents." H. Rep. No. 350, 67th Cong. 1st Sess., p. 16 (1939–1 Cum. Bull. (Part 2) 168, 180.) Congressman Hawley, in introducing the provision in the House, stated (61 Cong. Record, Part 5, p. 5202):

> Mr. HAWLEY. * * * We had instances before us where the books of a corporation or an individual had been examined four or five times, with four or five different assessments of taxation. There ought to be one levy of tax, one determination of it. It ought to be settled once for all when a man pays his tax, unless there should be good cause for a reexamination. * * *
>
> * * * * *
>
> Mr. CONNELL. There should not be another examination unless the first examination was wrong, and in that case the taxpayer should be notified in writing, should he not?
>
> Mr. HAWLEY. The gentleman is right, and we so provide. Of course the commissioner would not cause a frivolous examination to be made or an examination to be made on a frivolous ground. * * *

The report of the Senate Finance Committee, like the report of the House, confirmed that the measure

was "designed to meet the complaint of taxpayers that they are subjected to onerous and unnecessarily frequent examinations and investigations by revenue agents." S. Rep. No. 275, 67th Cong., 1st Sess., p. 31 (1939–1 Cum. Bull. (Part 2) 181, 203). When the measure reached the Senate floor, its purpose was further explained as follows (61 Cong. Record, Part 6, p. 5855):

> Mr. WALSH of Massachusetts. Mr. President, I think the chairman in charge of the measure ought to explain the importance of that provision, which I think is a very beneficial one, and perhaps call attention to the change it makes in existing law. It is a provision of which I heartily approve, but I think it is of such importance that some comment ought to be made upon it at this time.
>
> Mr. PENROSE. Mr. President, the provision is entirely in the interest of the taxpayer and for his relief from unnecessary annoyance. Since these income taxes and direct taxes have been in force very general complaint has been made especially in the large centers of wealth and accumulation of money, at the repeated visits of tax examiners, who perhaps are overzealous or do not use the best of judgment in the exercise of their functions. I know that from many of the cities of the country very bitter complaints have reached me and have reached the department of unnecessary visits and inquisitions after a thorough examination is supposed to have been had. This section is purely in the interest of quieting all this trouble and in the interest of the peace of mind of the honest taxpayer.

> Mr. WALSH of Massachusetts. So that up to the present time an inspector could visit the office of an individual or corporation and inspect the books as many times as he chose?
>
> Mr. PENROSE. And he often did so.
>
> Mr. WALSH of Massachusetts. And this provision of the Senate committee seeks to limit the inspection to one visit unless the commissioner indicates that there is necessity for further examination?
>
> Mr. PENROSE. That is the purpose of the amendment.
>
> Mr. WALSH of Massachusetts. I heartily agree with the beneficial results that the amendment will produce to the taxpayer.
>
> Mr. PENROSE. I knew the Senator would agree to the amendment, and it will go a long way toward relieving petty annoyances on the part of honest taxpayers.

These recitals make it abundantly clear that the only purpose of Section 7605(b) was to prohibit examinations which were "unnecessary" in the sense that they were repetitive to the point of harassment. *De Masters* v. *Arend*, 313 F. 2d at pp. 87–88. The statute remedied this situation by subjecting revenue agents to more stringent control at the administrative level, *viz:* a revenue agent could not conduct a re-examination of a taxpayer's books unless the Commissioner (or his delegated representative)[7] was satisfied "after investigation," that such a re-examination was "necessary". In the instant case, the findings of

[7] See Treasury Regulations, Sec. 301.7605–1(b) (26 C.F.R. 301.7605(b)).

agent Tiberino, with respect to the potential fraud liability of respondent corporation, were examined by Regional Commissioner Barron, who determined that an additional examination was necessary (R. 4a, 7a, 9a), and notified the taxpayer in writing to this effect (R. 9a).

Given the presumption of regularity which attaches to the acts of public officers (cf. *Wilson* v. *Schnettler*, 365 U.S. 381, 383), we cannot assume that the Regional Commissioner would have sanctioned a reexamination that was not "necessary", one that was undertaken only to harass or annoy the taxpayer or which sought information which was not "relevant or material" to an authorized inquiry. The only evidence offered by the taxpayer to rebut the presumption of necessity arising from the Commissioner's determination was that, in the absence of fraud, the statute of limitations on assessment of taxes had run as to the years involved. However, as we have previously shown, the expiration of the three-year statute did not make the examination "unnecessary," or even less "necessary," since the Commissioner clearly has the authority to examine records in order to ascertain whether a potential fraud liability exists. Accordingly, since the respondent corporation made no showing to impair the presumption of necessity, we submit that the district court should have enforced the summons on this basis alone.

In any event, however, if any further proof were needed, the agent's affidavit amply demonstrated to the court that the Regional Commissioner's decision to authorize the reexamination was justified. The affidavit stated that, "on the basis of information obtained in" a three-month investigation of the taxpayer's corporate income tax returns for the fiscal years 1958 and 1959, the agent had reason to suspect that the corporation "has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years" (R. 7a–8a). With information of overstated deductions in its possession, the Internal Revenue Service knew that respondent corporation might be liable for additional taxes due to fraud, and it would have been remiss if it had not pursued its investigation. The corporate books and records as to which examination is sought are obviously "relevant or material" in determining whether or not a fraud liability exists, and respondents have made no claim that production would be burdensome or oppressive. Nor have they raised any issue of arbitrariness or bad faith on the part of the Service. In sum, there is no basis for any claim that taxpayer is being subjected to an "unnecessary" investigation, and the district court was fully warranted in enforcing the summons.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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AUGUST, 1964.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6001. NOTICE OF REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary or his delegate may from time to time prescribe. Whenever in the judgment of the Secretary or his delegate it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary or his delegate deems sufficient to show whether or not such person is liable for tax under this title.

SEC. 6201. ASSESSMENT AUTHORITY.

(a) AUTHORITY OF SECRETARY OR DELEGATE.—The Secretary or his delegate is authorized and required to make the inquiries, determinations, and assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, or accruing under any former internal revenue law, which have not been duly paid by stamp at the time and in the manner provided by law. Such authority shall extend to and include the following:

(1) TAXES SHOWN ON RETURN.—The Secretary or his delegate shall assess all taxes determined by the taxpayer or by the Secretary or his delegate as to which returns or lists are made under this title.

* * * * *

(d) DEFICIENCY PROCEEDINGS.—

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * * *

(c) EXCEPTIONS.—

(1) FALSE RETURN.—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) WILLFUL ATTEMPT TO EVADE TAX.—In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

SEC. 7402. JURISDICTION OF DISTRICT COURTS.

* * * * *

(b) To Enforce Summons.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

* * * * *

(26 U.S.C. 7402.)

SEC. 7691. CANVASS OF DISTRICTS FOR TAXABLE PERSONS AND OBJECTS.

(a) General Rule.—The Secretary or his delegate shall, to the extent he deems it practicable, cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

* * * * *

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

SEC. 7604. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87, and Sec. 208(d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374].

ENFORCEMENT OF SUMMONS.

(a) JURISDICTION OF DISTRICT COURT.—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) ENFORCEMENT.—Whenever any person summoned under section 6420(e)(2), 6421(f)(2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It

shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

* * * * *

SEC. 7605. [As amended by Sec. 4(i), Act of April 2, 1956, c. 160, 70 Stat. 87 and Sec. 208(d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374].

TIME AND PLACE OF EXAMINATION.

(a) TIME AND PLACE.—The time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(f)(2), or 7602 shall be such time and place as may be fixed by the Secretary or his delegate and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2) or 6421(f)(2), the date fixed for appearance before the Secretary or his delegate shall not be less than 10 days from the date of the summons.

(b) RESTRICTIONS ON EXAMINATION OF TAXPAYER.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

U. S. GOVERNMENT PRINTING OFFICE:1956

IN THE

Supreme Court of the United States

October Term, 1964.

No. 54.

UNITED STATES OF AMERICA and ERNEST J. TIBERINO, JR., Special Agent, Internal Revenue Service,
Petitioners,

v.

MAX POWELL and WILLIAM PENN LAUNDRY, INC.,
Respondents.

On Writ of Certiorari of the United States Court of Appeals for the Third Circuit.

Brief for the Respondents.

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TABLE OF CASES CITED.

STATUTES AND RULES CITED.

QUESTION PRESENTED.

Whether the court below was correct in holding that the Internal Revenue Service, seeking judicial enforcement of its summons to produce a taxpayer's books and records for years as to which tax assessment and collection are time barred, must, upon challenge by the taxpayer, show the existence of facts which would justify a reasonable man in suspecting the existence of fraud or a willful intent to evade taxes, so as to lift the statutory time bar.

STATEMENT.

On February 26, 1963, the Regional Commissioner of Internal Revenue, Dean J. Barron, sent a form letter to the taxpayer, William Penn Laundry, Inc., which stated, "• • • it is deemed necessary to make a reinvestigation of the books and records of the William Penn Laundry, Inc. for the fiscal years ending July 31, 1958 and July 31, 1959 in order to properly verify its returns for those years. A re-examination, therefore, will be made" (R. 9a). The letter declared that it was sent in compliance with "• • • Section 7605 of the Internal Revenue Code of 1954" (R. 9a). No further statement of the purpose or grounds for the demand in the February 26 letter was proffered.

The books and records for the fiscal years covered by the letter—1958 and 1959—had earlier been examined by Internal Revenue Agents, at which time technical adjustments were made and deficiency taxes were assessed and paid (R. 22a-23a). Assessment and collection of taxes for these years, except in the event of fraud or wilful attempt to evade payment of taxes, was time-barred; at the time of the demand, 1958 and 1959 were "closed years". 26 U. S. C. § 6501.[1]

The letter was followed by a summons, dated March 12, 1963, directed to Mr. Max Powell, President of William Penn Laundry, Inc.[2] (R. 10a-11a). This summons, covering the same fiscal years and declaring that it was "Issued under authority of Section 7602, Internal Revenue Code of 1954," was signed by Special Agent Ernest J. Tiberino, Jr. It directed Mr. Powell to

> "• • • produce for examination the following books, records, and papers • • •

---

1. Unless otherwise indicated, all references to statutory sections herein are to the Internal Revenue Code of 1954.

2. During the years involved in this case, Mr. Lawrence C. Kline was President and sole stockholder of the Company. Mr. Powell became President upon Mr. Kline's death but has no stock interest in the Company.

"Minute books

"Stock certificate books

"General ledgers

"General journals

"Purchase journals and cash disbursement journals

"Sales journal and cash receipts journals and all subsidiary records kept to substantiate the entries in the above-mentioned records." (R. 10a)

Mr. Powell appeared on March 25, 1963 at the appointed hour and place at the Internal Revenue Service offices in Philadelphia but declined, on the advice of counsel, to produce the books or records demanded (R. 15a-16a). Counsel for the taxpayer made plain on the record the basis of his advice to Mr. Powell:

"* * * It is his desire, and the company's desire, to cooperate in every way that is proper and legal. However, in view of the fact that the Statute of Limitations has expired for the two years for which time you have requested records, plus the fact that these years were previously examined and the principal officer at the time is no longer living, I have advised Mr. Powell to decline to produce these records and to waive any legal rights which the corporation may have or which he may have.

"It is our position that this is an unreasonable examination, and in view of the expiration of the Statute of Limitations, such examination would be illegal. To Mr. Powell's knowledge, the returns of the corporation for the years in question are correct and he has no reason to know of any discrepancies which could be the basis for an allegation of fraud. Under the circumstances, unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years.

* * *

> "If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the Statute of Limitations provision in the Internal Revenue Code." (R. 16a-17a)

Special Agent Tiberino's response to this request to give "some indication" as to the reason for the investigation and demand to produce was:

> "O. K. gentlemen, in view of the position taken today, there is no point in carrying this meeting any further at this time." (R. 17a)

The administrative proceeding was thereupon adjourned.

Two months later—May 20, 1963—a petition to enforce the Internal Revenue Service summons, based on Section 7604(b) of the Internal Revenue Code of 1954, 26 U. S. C. 7604(b), was filed in the District Court for Eastern District of Pennsylvania (R. 3a-5a). The petition referred to the letter of demand and the summons, but set forth no factual basis for the administrative demand that the books and records be made available. The petition merely alleged that the taxpayer had been notified that "• • • an additional inspection of [the taxpayer's] books and records was necessary" (R. 4a).

Attached to the petition was an affidavit of Special Agent Tiberino (R. 7a-8a). In the affidavit, the Special Agent said that, based upon his investigation of the corporate income tax returns of this taxpayer, "• • • the Regional Commissioner • • • determined that an additional examination • • • was necessary" (R. 7a). Special Agent Tiberino also stated that he had delivered to Mr. Powell the letter which set forth that "• • • an additional inspection of their books and records was necessary" (R. 7a). Giving, for the first time in these proceedings, any indication whatever of the occasion for the proposed

re-examination, the Special Agent asserted in the affidavit filed in the district court that "• • • he has reason to suspect that the William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958, and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years" (R. 7a-8a).[3]

The petition to enforce prayed that "• • • the Court enter an order directing the respondent, Max Powell, to obey the aforementioned summons in each and every requirement thereof, and to order the attendance and production of books and records as required and called for by the terms of such summons before Special Agent Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service, at such time and place as may be hereafter fixed by said Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service" (R. 5a).

On May 27, 1963, an order was issued by the district court, returnable on June 5, 1963, directed against Powell, to show cause why the demanded books and records should not be produced for inspection (R. 2a). A response to the show cause order was filed on behalf of the taxpayer (R. 22a-24a).

At the hearing on the order to show cause, the Internal Revenue Service persisted in its position, begun with the Regional Commissioner's letter of February 26th, that the taxpayer must produce the records on the basis of an unsupported administrative demand (R. 31a-32a, 36a). Recognizing that assessment and collection of taxes for the years in question were time-barred unless the case fell

3. The affidavit did not, however, give any clue as to the assets as to which there had been an alleged overstatement, or how "purchases", an element in cost of goods sold, could have been reported as "expenses".

within one of the statutory exceptions, Internal Revenue nevertheless stated (R. 29a-30a) "* * * the Government should not be required to prove grounds for belief that the liability was not time barred." Accordingly, Internal Revenue refused to produce the Special Agent, or any witness, to support the demand.

In the alternative, Internal Revenue urged the district court to accept Tiberino's affidavit as a sufficient showing of probable cause and argued that Tiberino's affidavit was sufficient to justify judicial enforcement (R. 31a). Counsel for the taxpayer, on the other hand, pointed out that there had been no "* * * attempt to justify or explain * * *" the demand and that there were no facts shown whatsoever to support the Special Agent's general statement that he had "* * * reason to suspect * * *" fraud (R. 35a).

The district judge expressed dissatisfaction with the refusal of the Internal Revenue Service to present testimony and stated agreement with the position taken by taxpayer (R. 31a-32a, 36a-38a). Nevertheless, the district judge decided upon a compromise order whereby he permitted examination of the taxpayer's books and records for one hour only. He declared:

> "* * * I am inclined to go along with [counsel for taxpayer's] argument from reading this, but as a practical matter, an hour examination of these books in a courteous way, understand—I don't know how the Special Agent acts, but if he will do this in a courteous way and a kindly way, without assuming these people are guilty of anything, I am inclined to let them have an hour to do this." (R. 37a-38a) [4]

4. In its brief in this Court (Br., p. 4), as in its petition for certiorari (Pet., p. 8), the Government refers to this curious order of the district court as containing "* * * certain limitations not here pertinent * * *". Elsewhere, the Government's brief (p. 21) states that the district court "was fully warranted in enforcing the summons". Actually, it is apparent, and the transcript of the hearing bears this out, that the district judge actually sought to avoid resolution of the issue presented (R. 37a-39a).

Counsel for the taxpayer, of course, protested this ruling, stating that the taxpayer should not be ordered to turn its books over to the Special Agent "* * * just because he wants to see them * * *" but that "* * * the crux of this case * * *" was whether the Special Agent had established the right to see the books (R. 40a).

Following some further colloquy, the district court entered an order setting June 10, 1963, from 10:00 to 11:00 A. M. as the period during which the Agents should have access to the books (R. 45a).

The taxpayer appealed from this order on June 7, 1963 and, pursuant to stipulation, an order was entered on June 10, 1963, staying the scheduled one hour examination (R. 46a). In order to make perfectly plain the principle at issue in this case, the taxpayer agreed that if the position of the Internal Revenue Service were sustained, the Agents should be permitted a reasonable time, not limited to one hour, in which to complete a re-examination (R. 47a).

The Court of Appeals for the Third Circuit, in an opinion by Judge Hastie, reversed the district court (R. 49-53). Speaking for a unanimous court, Judge Hastie first considered the question of the district court's responsibility when called upon to enforce a demand by the Internal Revenue Service such as that here involved. Referring to Section 7604(b) on which the petition to enforce was grounded, Judge Hastie rejected the argument of the Service that the basis for the Special Agent's suspicion of fraud was not a matter for judicial cognizance. Section 7604(b) requires the production of "* * * satisfactory proof * * *" and "* * * a hearing of the case * * *" as the basis for "* * * such order as [the judge] shall deem proper * * *".

Since assessment or collection of taxes was here time-barred under Section 6501, and since Section 7605 of the Internal Revenue Code of 1954 prohibits unnecessary examinations, the court below concluded "Logically, therefore, a reexamination of his records must be 'unnecessary'

within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year • • •" (R. 51). Therefore, inasmuch as the Internal Revenue Service had not disclosed any facts which might cause a reasonable man to suspect fraud, any facts sufficient to show "• • • that the decision to proceed was not arbitrary", the court held that the Internal Revenue Service summons was not entitled to judicial enforcement (R. 53).

SUMMARY OF ARGUMENT.

In this case, the Internal Revenue Service called upon a federal district court to enforce a summons which directed the taxpayer to produce books and records for closed years. The petition alleged no more than that the taxpayer had been notified that the requested examination was necessary.

The Internal Revenue Service takes the position that, on this basis alone, the order of enforcement should have been issued by the court. The argument of the Service, in support of its position, is that the only limitation upon its power to investigate is the prohibition against "* * * unnecessary examination * * *" in Section 7605(b), and that the prohibition of this section is fully satisfied by an administrative determination of necessity.

The court below correctly rejected this argument, an argument which has, in fact, never been accepted by any court when called upon to enforce an Internal Revenue summons. Rather, the decision below was properly grounded in a reading of the various applicable sections of the Internal Revenue Code as an integrated whole, including those sections which deal with the responsibility of federal courts in enforcement cases. The result below, and the reading there given to the statutory sections involved, fully accord with this Court's decision in **Reisman v. Caplin**, 375 U. S. 440 (1963).

The first point of analysis is an examination of the various sections of the Code here involved. The power to investigate granted to the Internal Revenue Service by Section 7602 pre-supposes investigations for a lawful purpose, *i.e.*, the Internal Revenue Service can investigate where it possesses the power to assess and collect income tax. Here, Section 6501 prohibits assessment unless it takes place within three years of the date upon which the return in question is filed, unless this time bar upon the

investigative powers of Internal Revenue is lifted on the sole ground that the case involves fraud or another of the stated exceptions to Section 6501. A further limitation on the investigative power of Internal Revenue is supplied by the prohibition against "* * * unnecessary examination or investigations * * *" of Section 7605(b). Construing these sections together, the court below correctly concluded that, absent a showing of a reasonable basis for suspecting that the matter falls within an exception to the statute of limitation section, the demand of Internal Revenue for enforcement must be viewed as unnecessary and prohibited, because time-barred.

The conclusion reached by analysis of those sections of the Code which deal with the investigative powers of the Internal Revenue Service is re-enforced by consideration of the sections which deal with judicial enforcement of an Internal Revenue summons. Whichever enforcement procedure is followed, it is clear that the taxpayer is entitled to an adjudication of his challenges to the summons in an adversary proceeding. The dispositive principle is clearly expressed in this Court's decision in the **Reisman** case.

The constitutional decisions, upon which the Government relies in support of its argument, are not apposite. Those decisions pre-suppose that the Administrative investigations, being challenged on Fourth and Fifth Amendment grounds, was within the statutory authority of the agency. Here, of course, the very question is whether Internal Revenue has statutory power to make its proposed investigation.

An analysis of all of the reported cases which have considered the question here presented shows plainly that on no occasion has the argument which Internal Revenue advances been accepted. In any case in which enforcement has been granted, the court's order has been based on a record which contains some showing by Internal Revenue of factual support for its suspicion. The earliest

cases flatly rejected an argument somewhat similar to that here advanced by Internal Revenue, *i.e.*, that no showing need be made. And, for a time, the Internal Revenue Service seemingly accepted the rule that it must make a showing of probable cause in order to obtain judicial enforcement. It is significant that the Internal Revenue laws have, since these early decisions, been twice thoroughly examined and codified by Congress. At no time has Internal Revenue sought to obtain from Congress statutory language which would convey the unlimited investigative power for which it here argues. To the contrary, Congress has twice re-enacted the language of the sections involved in this case, as judicially construed, without any material change.

The principal argument of Internal Revenue—the only argument which relates to the single question presented by the Government's petition for certiorari—is, as we have shown, that the court must grant enforcement of a summons upon a certification that there has been an administrative determination of necessity. In the alternative, and accepting the rule that probable cause must be shown, Internal Revenue urges this Court to accept a general conclusory statement of suspicion contained in an affidavit of Special Agent Tiberino as a sufficient showing. The Government's petition for certiorari did not present any question as to the adequacy of the showing made by the Service in the district court and, accordingly, this alternative argument is not available to the Government in this Court. Rule 40(d)(2). In any event, no court has ever accepted a comparable statement as a sufficient showing of fact and several cases have specifically rejected general statements contained in affidavits by agents, as a sufficient basis upon which to grant enforcement. More to the point, however, is the fact that, in a related case, containing precisely the same general statement by the same Special Agent, the Internal Revenue Service elected to produce proof, offering further affidavits and live testi-

mony. After hearings, argument and briefing, the federal district judge before whom the case came, concluded that Internal Revenue had failed to show any sufficient facts to justify a reasonable man in suspecting fraud. In short, Internal Revenue was entirely unable to substantiate its suspicion. Nevertheless, it here calls upon this Court to accept the charge itself as an adequate showing of facts upon which a reasonable man would suspect the existence of fraud in the taxpayer's returns for 1958 and 1959.

Argument.

THE COURT BELOW CORRECTLY HELD THAT THE INTERNAL REVENUE SERVICE WAS NOT ENTITLED TO JUDICIAL ENFORCEMENT OF ITS SUMMONS SINCE THE SERVICE MADE NO SHOWING OF FACTS WHICH WOULD LEAD A REASONABLE MAN TO SUSPECT THAT THE CASE CAME WITHIN AN EXCEPTION TO THE APPLICABLE STATUTE OF LIMITATIONS.

Introductory Statement.

The petition for enforcement which, the Government contends, should be held sufficient to justify a district court order directing this taxpayer to produce its books and records for closed years, alleges no more than that the Regional Commissioner deemed it necessary that examination of such books take place, and that the taxpayer had been so notified (R. 3a-4a). In other words, the Government's basic position here is that the mere statement, without more, that an administrative determination that an examination is necessary has been made, requires a federal district court, upon application by the Internal Revenue Service, to compel compliance by the taxpayer.[5]

The argument in support of this contention consists principally of isolating Section 7605(b) from the other relevant provisions of the Internal Revenue Code and treating that section alone as critical in determining the circumstances in which judicial enforcement will be forthcoming. Accepting the prohibition against "* * * un-

5. We are here dealing with the sole question presented by the Government's petition for a writ of certiorari (Pet., p. 2). See also, Gov't. Brief, p. 2. As to a contention with respect to the sufficiency of Tiberino's affidavit, not raised as a question presented in the petition, see *infra*, pp. 39-42.

necessary examination * * *" contained in Section 7605(b) as a limitation upon the right to obtain judicial enforcement of a summons (Br., p. 13), the Government urges that the requirement is met where the Regional Commissioner determines, after investigation by him, that an examination of the books and records in question is necessary (Gov't. Br., pp. 19-20).[6] The argument next attaches a presumption of regularity to the determination of the Regional Commissioner, which is then transformed into a "* * * presumption of necessity * * *" (Gov't. Br., p. 20). Thereupon, in the Government's view, a district court must enforce this summons unless the taxpayer somehow overcomes this "* * * presumption of necessity * * *", even where, as here, the taxpayer is faced with a naked petition, alleging necessity and nothing else (Gov't. Br., p. 20).

The Government's argument completely ignores the integrated nature of those sections of the Internal Revenue Code which are here of critical concern, particularly of those sections which define the interplay between the power of the Internal Revenue Service and the responsibility of federal district courts in enforcement cases. This Court recently recognized, in **Reisman v. Caplin**, 375 U. S. 440, 450 (1963), "* * * the comprehensive procedure of the Code, which provides full opportunity for judicial review before any coercive sanctions may be imposed. * * *" The entire thrust of the **Reisman** case is that, in an enforcement proceeding by the Internal Revenue Service, the taxpayer is entitled to an adversary hearing in which he may obtain a judicial determination of his challenges, on any appropriate ground, to the summons, 375 U. S. at pp. 446, 449.

Those sections of the Internal Revenue Code which deal with the jurisdiction of district courts and the pro-

6. The Government suggests that the main purpose of Section 7605(b) was to avoid repetitious re-examinations of taxpayers by overzealous agents, and that this danger is completely overcome where the determination to make the examination is reviewed by the agent's superior, the Regional Commissioner (Gov't. Br., pp. 17-20). As to this argument, see *infra*, pp. 36-39.

cedures for enforcement of an Internal Revenue summons have existed for many years, dating back to 1913 and earlier. They have been before Congress and, with minor changes, have been re-enacted in major revisions and codifications of the Internal Revenue laws. The position which is here being urged by the Government—that, in order to obtain judicial enforcement of an Internal Revenue summons, no showing of probable cause or reason to suspect fraud need be made—is essentially the same as that which was urged and rejected as early as 1937. **In re Andrews' Tax Liability**, 18 F. Supp. 804 (D. Md., 1937); **In re Brooklyn Pawnbrokers, Inc.**, 39 F. Supp. 304 (E. D. N. Y., 1941). Following these decisions, the Internal Revenue Service apparently accepted the rule that, in order to obtain enforcement, a showing of probable cause or reasonable ground for suspicion of fraud had to be made in order to gain access to books and records for closed years. **Martin v. Chandis Securities Co.**, 128 F. 2d 731, 735 (C. A. 9, 1942). No change in the language of the jurisdiction and enforcement sections of the Code was sought. Rather, the Internal Revenue Service has renewed its contentions in the courts, seeking favorable language while, at the same time, presenting a factual showing. Only in this case has the Service put its position squarely at risk by filing a petition devoid of information as to the basis upon which access to the taxpayer's books and records was being sought, refusing even to produce a witness.

It is our position that the provisions of the Internal Revenue Code must be read together, just as Judge Hastie did. So read, it is plain, and this Court's recent decision in **Reisman** underscores the conclusion, that the Internal Revenue Service, in order to obtain judicial enforcement of a summons which seeks access to books and records for closed years, must do more than merely assure the district court that it has been administratively determined that such examination is necessary. Rather, the Service carries the burden of a preliminary showing of reason to suspect the

existence of fraud, or of some other circumstance which would bring the matter within the exceptions to the statute of limitations of Section 6501.

A. The Statutory Scheme: Investigative Power.

Section 7602 charges the Internal Revenue Service with the responsibility of "* * * ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any Internal Revenue tax * * *". In aid of this duty, the Service is empowered to examine books and records, to require testimony, and to compel the production of books and records.

The critical point of departure in the exercise of power under Section 7602 is the date upon which the return is filed. Assessment and collection of federal income tax is largely self-executing. By filing a return, the taxpayer assesses his taxes; by remitting his check, the taxpayer collects his own taxes for the Internal Revenue Service. Section 6501 provides, in chief, that assessment by the Internal Revenue Service of the tax owed by any taxpayer, must take place within three years after the return is filed. After the three year limitations period has expired, "* * * a person is liable for tax * * *" only in the case of "* * * a false or fraudulent return with the intent to evade tax * * *" or "* * * a willful attempt in any manner to defeat or evade tax * * *". Section 6501(c).[7]

In other words, unless one of the exceptions to the three-year statute of limitations is involved, there is no power in the Internal Revenue Service to assess or collect income tax. Absent the power to assess and collect, there is no power to determine liability for tax or ascertain the correctness of any return, and, accordingly, no power to investigate under Section 7602. Section 6501, therefore,

7. Two other exceptions—failure to file a return and extension by agreement—are concededly not involved in this case. Likewise, the six-year statute of limitations, applicable in cases of failure to report more than 25 percent of the amount of gross income reported, is not involved in this case.

imposes a clear limitation on the power to investigate conveyed by Section 7602.

A further limitation on the investigative powers is imposed by Section 7605(b) which provides that no taxpayer "* * * shall be subjected to unnecessary examination or investigations, * * *". The prohibition of Section 7605(b) is, of course, applicable whether or not the proposed investigation under Section 7602 involves taxable years as to which the statute of limitations has expired. If the statute has run, as we have pointed out above, the investigative power under Section 7602 is subject to the further specific limitation which flows from the provisions of Section 6501.

The books and records here in controversy relate to taxable years ending on July 31, 1958 and July 31, 1959 (R. 4a). Federal income tax returns for each of those years were duly filed and had earlier been examined by Internal Revenue Agents, at which time technical adjustments were made and deficiencies were paid (R. 33a). The three-year statute of limitations on further assessment of taxes had run long before February 26, 1963, the date of the form letter of demand sent to the taxpayer by the Regional Commissioner.[8]

Given these facts, it is clear that the power to conduct an investigation under Section 7602 into books and records of closed years cannot, as the Government contends, turn on an unexplained, administrative determination that the proposed examination is necessary. The statute of limitations section, Section 6501, not only imposes a limitation upon the investigative powers but also furnishes, in the circumstances of this case, an objective standard as to what is or is not necessary. Where the limitations period has expired, the demanded examination is presumptively unnecessary. Upon challenge by the taxpayer, the Internal

8. The form letter of February 26, 1963 was sent as a compliance to that portion of Section 7605(b) which requires notice that a second inspection of a taxpayer's books is contemplated.

Revenue Service must overcome this presumption. If there is no basis upon which a reasonable man could suspect a case of fraud or a wilful attempt to evade payment of tax, there is no basis for suspending the three-year bar of Section 6501. If there is such a basis for lifting the time bar, it must be shown when Internal Revenue goes to court for enforcement of its summons. Judge Hastie accurately and succinctly recognized this as the issue presented for decision, based on those sections of the Internal Revenue Code which deal with the investigative power of the Service: "* * * Logically, therefore, a reexamination of his records must be 'unnecessary' within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year * * *" (R. 51).

B. Statutory Scheme: Enforcement.

On the basis of the above analysis of the relationship between those sections which alone govern the Service's power of investigation, it is clear that, when the Service seeks judicial enforcement of a summons which requires the production of books and records for closed years, a showing must be made that the Service is acting within its statutory power. That conclusion is fortified by a consideration of the role of the courts under the enforcement provisions of the Code, particularly in the light of the Government's argument that the court must act on the basis of a bare certification that the proposed investigation has been administratively determined to be necessary.

The petition for enforcement in this case was filed under Section 7604(b) (R. 3a). Commenting on this section, Judge Hastie said (R. 51):

> "* * * we consider it significant that section 7604(b) requires a 'hearing' on the application to enforce the administrative summons at which 'satisfac-

> tory proof' shall be made. We think this provision means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. * * *"

The Government, in this Court, seeks to avoid the force of Judge Hastie's reasoning by a so-called confession of error. Its brief describes the reference to Section 7604(b) in its enforcement petition as "* * * mislabelling * * *" and attributes this "* * * mislabelling * * *" to the portion of this Court's decision in the **Reisman** case (375 U. S. at pp. 448-449) which condemned the use of body attachment except in cases of contumacious refusal (Br., p. 11, ftn. 2).[9] The Government says nothing as to alternative enforcement sections—Sections 7604(a) or 7402(b)—or the scope of the hearing which would be required if such alternative had been selected. The suggestion seems to be that a satisfactory showing of probable cause justifying enforcement of a summons need be made only under Section 7604(b).

There are a number of dispositive answers to this suggestion by the Government that Judge Hastie's reasoning, which led him to conclude that a hearing was required, should be discounted because he "erroneously" referred to Section 7604(b).

First, we question whether the Government can be permitted, on the basis of its allegedly mistaken use of Section 7604(b), to seek to better its position here by attempting to delete from the case any consideration of the enforcement sections of the Code. A true confession of error, based on original mistake or an intervening ruling which affects the case, should lead to a withdrawal by the party making confession. Here, in contrast, the Govern-

9. The Government also makes a technical argument based on the language of Section 7604(b) to the effect that the "* * * hearing * * *" on the validity of the summons, referred to in that section, takes place after the attachment which the section permits (Br., p. 11). This recognizes that an adversary proceeding on the merits is required.

ment employs its alleged mistake as a device for arguing a new position, namely, that the enforcement sections of the Code need not be examined or construed in resolving the issue presented.

That this "mislabelling" argument of the Government is a mere stratagem, designed to further its argument in this Court, can easily be demonstrated. The choice of enforcement section does not determine whether or not a hearing is necessary, a fact which the Government itself has plainly recognized. In its brief to this Court in **Reisman v. Caplin**, Oct. T., 1963, No. 119, the Government emphasized that a hearing would be required "• • • whether the Commissioner proceeds by way of section 7402(b), 7604(a) or 7604(b) • • •" (Gov't. Br. in No. 119, p. 18). The position taken by the Government in **Reisman** is correct and completely refutes the suggestion here being made that Judge Hastie's conclusion as to the need for a hearing disappears because he referred to Section 7604(b) rather than to another enforcement provision.

Second, the Government's suggestion places it on the horns of a dilemma. Essentially, the Government is arguing that this entire proceeding, from the outset, was incorrect. If that be so, the Government is out of court. *Cf.* **Application of Howard**, 325 F. 2d 917, 919-920 (C. A. 3, 1963). If the Government is not willing to accept this result, it must then accept the record as made and argued to both courts below by its experienced tax attorneys. In other words, under the latter alternative, the case must be considered as involving Section 7604(b).

Third, the Government's attempt to delete from the case any consideration of the enforcement sections of the Internal Revenue Code amounts to raising an argument not made in either court below and one which materially affects the consideration of the issue presented. We respectfully suggest that, as petitioner, the Government may not be per-

mitted thus to alter the nature of the case, to its advantage, by a so-called confession of error.

In any event, there is no substance to the Government's suggestion that some difference would have resulted, as to the requirement of a hearing, if this case had been instituted under Section 7604(a) or 7402(b). As the Government itself stated in its brief in the **Reisman** case, a hearing would have been required in any event and precisely the same issue as to the need for a showing by the Service of probable cause as a condition precedent to judicial enforcement would have been presented.

Section 7604(b) plainly prescribes an adversary proceeding. It is equally plain that Section 7604(a) requires an adversary proceeding.

Section 7604(a) provides:

> "(a) *Jurisdiction of district court.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data." [10]

It was early noted that—unlike Section 7604(b) and its predecessor section—Section 7604(a) created jurisdiction but contained no provision specifying the procedure to be followed in invoking that jurisdiction; that accordingly the Federal Rules of Civil Procedure would apply, with the

10. Section 7402(b) is substantially identical with Section 7604(a) in that it vests jurisdiction in the district courts to enforce summons. Section 7604(a) differs from 7402(b) only in that it includes "records" among the taxpayer's papers which may be compelled, and in that it defines venue as the district where the taxpayer "resides or is found" rather than the district where the taxpayer "resides or may be found". Both Section 7604(a) and Section 7402(b) derive from Section 3633 of the Internal Revenue Code of 1939. The reason for the appearance of the section at two places in the 1954 Code is obscure.

proceedings instituted by the filing and service of a complaint. **Martin v. Chandis Securities Co.**, 128 F. 2d 731, 734 (C. A. 9, 1942); see, also, **United States v. Ryan**, 320 F. 2d 500, 501 (C. A. 6, 1963), No. 12, this Term; **Application of Howard**, 325 F. 2d 917, 919-920 (C. A. 3, 1963).

In other words, if this proceeding had been instituted under Section 7604(a), the initial pleading would have been a complaint, followed by answer and hearing. There may be some difference in the immediacy of coercive sanctions as between the two sections, but there is no possible difference in the nature of the hearing to be held on the validity of the summons. Under either section, 7604(a) or 7604(b), an adversary hearing takes place in which the Internal Revenue Service is called upon to satisfy the court, by a showing of probable cause, that it is acting within its jurisdiction.

An examination of the reported cases completely bears out the fact that the issue presented, the nature of the showing which the Service must make in order to obtain enforcement, is the same whether the proceeding be instituted under Section 7604(a) or Section 7604(b). Three reported cases involved body attachment proceedings under Section 7604(b). **Brownson v. United States**, 32 F. 2d 844 (C. A. 8, 1929); **Jarecki v. Whetstone**, 192 F. 2d 121 (C. A. 7, 1951); **Boren v. Tucker**, 239 F. 2d 767 (C. A. 9, 1956). Three of the reported cases state that the enforcement proceeding was brought under Section 7604(a) or its predecessor. **McDermott v. John Baumgarth Co.**, 286 F. 2d 864 (C. A. 7, 1961); **People's Deposit & Trust Co. v. United States**, 212 F. 2d 86 (C. A. 6, 1954); **Falsone v. United States**, 205 F. 2d 734 (C. A. 5, 1953). And four of the cases were said to have been brought under Section 7604 but no reference is made to the particular sub-section involved. **Foster v. United States**, 265 F. 2d 183 (C. A. 2, 1959); **United States v. Ryan**, 320 F. 2d 500 (C. A. 6, 1963); **O'Connor v. O'Connell**, 253 F. 2d 365 (C. A. 1, 1958); **Wall v. Mitchell**, 287 F. 2d 31 (C. A. 4, 1961). In

all of these cases, irrespective of the specific part of Section 7604 which was invoked by the Internal Revenue Service, the courts considered the same issues to be involved and the Government accepted that reading of the statute.

In short, the Government cannot eliminate from consideration the critical enforcement sections and the responsibility imposed on the courts by those sections by a confession that this case should have been brought under Section 7604(a) instead of 7604(b). Here, again, the dispositive principle has been expressed by this Court in **Reisman**. The Court held that, whatever form enforcement took, the taxpayer was entitled to a judicial determination of his challenge to an Internal Revenue summons in a full adversary proceeding. 375 U. S. at pp. 446, 449, 450. In the instant case, the taxpayer pointed out from the outset that the statute of limitations had run on the years in question and called upon the Service to justify the proposed investigation. The Service could, as it did, refuse flatly the taxpayer's request at the administrative hearing. But when the Service sought judicial enforcement, it was under a duty to establish, to the district court's satisfaction, that it was acting within its statutory power. This duty was in no way discharged by a flat refusal to show any facts upon which a reasonable man could have suspected the existence of fraud.

C. The Cases: Constitutional Decisions.

As we have shown, the Internal Revenue Service refuses to recognize the inter-relationship between Section 6501, the statute of limitations section, Section 7605(b), prohibiting "* * * unnecessary examination or investigations * * *", and Section 7602, the power to investigate section.

The Government also makes an argument based on Section 7602, standing alone, an argument which, again,

avoids the difficult issue of statutory authority and is designed to lead to the conclusion that the Service itself can administratively determine the scope of its statutory authority (Br., pp. 12-13).[11]

Assuming the statutory validity of the purpose for which the investigation is undertaken, the Internal Revenue Service urges that the only question is the relevancy and materiality to the investigation of the information sought. On these assumptions, the Government cites **Oklahoma Press Pub. Co. v. Walling**, 327 U. S. 186 (1946), and **United States v. Morton Salt Co.**, 338 U. S. 632 (1950), both for the proposition that the requirement of relevancy and materiality contained in Section 7602 is precisely the same as that announced by this Court in those cases. The Government, of necessity, argues from these cases that not only has the Internal Revenue Service the power to determine the relevancy and materiality of the information sought, but also has the power to determine its own authority to conduct the investigation. In those cases, involving Fourth and Fifth Amendment challenges to the exercise of administrative investigatory power, this Court has always adjudged the constitutional issue on the premise that the administrative investigation was within the statutory authority of the agency. In this case, of course, the scope of the Internal Revenue Service's statutory authority is the very question at issue.

Thus, in **Oklahoma Press Pub. Co. v. Walling**, *supra*, this Court pointed out that "* * * the Administrator's action was in exact compliance * * *" with the broad grant of statutory power conveyed to him by Congress (327 U. S., at p. 201). On this premise, the Court proceeded to consider the constitutional objection to the particular exercise of statutory power, and it was in connection with

11. In connection with this argument, the Government also recites other sections of the Code, such as Sections 6201, 7601, 6001, which, while they spell out various aspects of the investigative power of the Service, are of no relevance here.

the constitutional issues that the Court used the "reasonableness" test relied on by Internal Revenue Service here.

The teaching of **Oklahoma Press** is that, to sustain the constitutionality of a particular administrative investigation, it is enough that the investigation is reasonably related to duties imposed on the agency by Congress in the proper exercise of its legislative powers. But, throughout its opinion, this Court repeatedly insisted that, without regard to constitutional issues, the administrative inquiry must be within the scope of the investigatory power granted by Congress. Thus, the Court states, "It is enough that the investigation be for a lawfully authorized purpose * * *" (327 U. S., at p. 209) and that the administrative official involved "* * * shall not act arbitrarily or in excess of his statutory authority * * *" (327 U. S., at p. 216). In **Oklahoma Press**, this Court plainly held that "* * * The Administrator is authorized to enter and inspect, but the Act makes his right to do so subject in all cases to judicial supervision. Persons from whom he seeks relevant information are not required to submit to his demand, if in any respect it is unreasonable or overreaches the authority Congress has given. To it they may make 'appropriate defence' surrounded by every safeguard of judicial restraint. * * *" 327 U. S., at p. 217.

United States v. Morton Salt Co., 338 U. S. 632 (1950) adds little to the Government's argument. There, this Court held that the Federal Trade Commission, in the exercise of its broad statutory powers to investigate, could demand continuing reports of compliance with a cease-and-desist order. In the instant case, the Government quotes language from **Morton Salt** in which this Court rejected the notion that judicial limitations could be engrafted upon the extremely broad investigative powers which had been conveyed by Congress to the Federal Trade Commission (Br. p. 13). But the question whether the Federal Trade Commission is subject to judicially imposed limitations in the exercise of investigatory powers under its organic act is

not, we suggest, relevant to the question whether the Service can, in the circumstances of this case, flatly decline to disclose any basis for its proposed investigation.

Here, the taxpayer has challenged the statutory authority of the Service to make the proposed investigation, on the ground that there was no reason to believe that the investigation was directed at a proper purpose in view of the time bar. This Court's recent decision in **Reisman v. Caplin**, *supra*, is replete with references to the taxpayer's right to question the propriety of an Internal Revenue Service summons in an adversary proceeding. "Any enforcement action under this section [Section 7402(b), the general jurisdictional section identical with Section 7604 (a)] would be an adversary proceeding affording a judicial determination of the challenges to the summons and giving complete protection to the witness. * * *" Id., 375 U. S. at p. 446. "* * * **the Government concedes** that a witness or any interested party may attack the summons before the hearing officer. * * *" Id., 375 U. S. at p. 445. (Emphasis added.) "Furthermore, we hold that in any of these procedures [under Section 7210, Section 7402(b) or Section 7604(b)] before either the district judge or United States Commissioner, the witness may challenge the summons on any appropriate ground. * * *" Id., at p. 449.

D. The Cases: The Basis for Enforcement of an IRS Summons.

In the two cases before this Court today—this case and **United States v. Ryan**—the Internal Revenue Service asserts that it possesses a statutory right to unlimited access to any taxpayer's books and records, so long as a local Regional Commissioner subjectively believes that examination of the records is necessary. The Government takes the determination of the Regional Commissioner "* * * that an additional examination was necessary * * *" (Br., p. 20), adds the presumption of regularity in acts done by public officers and concludes that "* * * the district court

should have enforced the summons on this basis alone." (Br., p. 20).

Contrary to the Government's statement (Br., p. 8), there is no square decisional support for this conclusion. There is no case anywhere, in which a district court has ordered enforcement of a summons requiring a taxpayer to produce records for closed years where, as here, the Government has declined to show the basis for its investigation. There have been cases in which the Government has argued that it need do nothing more than state a subjective suspicion of fraud, but when the lines were drawn, the Government disclosed facts which recognized the burden of establishing probable cause or reasonable ground for suspicion of fraud. When the burden was not met, enforcement was denied by the courts.

The cases may be divided into three categories.

In one category of cases, the Fourth and Seventh Circuits, while declining to formulate a fixed standard, were careful, in affirming district court orders enforcing a summons, to note that the Government evidence met the test of probable cause. **Wall v. Mitchell**, 287 F. 2d 31 (C. A. 4, 1961); **McDermott v. John Baumgarth Co.**, 286 F. 2d 864 (C. A. 7, 1961). The Government agrees with this reading of these cases (Br., pp. 8-9).

The principle developed in a second category of cases, cases arising out of the First and Ninth Circuits, as well as the court below, results in a judgment adverse to the Government on the facts of this case since they state a "probable cause" or "reasonable ground to suspect fraud" test.

One of the leading cases in this category is **O'Connor v. O'Connell**, 253 F. 2d 365 (C. A. 1, 1958). There, the Court reversed an order directing the taxpayer to appear and testify as to tax liabilities for closed years. The Special Agent testified that "substantial increases in the net worth of the respondent during the years in question led him [the Agent] to strongly suspect that the respondent taxpayer

has grossly understated his income . . . and that his return may have been false and fraudulent."

The Court stated the question as follows (253 F. 2d at p. 369):

> "* * * Our concern is with what the tax authorities must show to warrant enforcement of a summons directing a taxpayer himself to testify with respect to possible deficiencies in his taxes for years 'closed' by the statute of limitations except for fraud. The question is: Do the tax authorities only need to show the enforcing court that they entertain a *bona fide* suspicion of fraud on the part of the taxpayer for those years, or must they establish to the satisfaction of the court that there is probable cause or a reasonable basis for it to believe that in those years the taxpayer perpetrated a fraud upon the revenue?"

The Court recognized the importance to the enforcement of the tax laws of the rule that the Service is entitled, as a matter of right, to compliance with any reasonable summons respecting years not barred, without regard to the burden on the taxpayer. But the Court pointed out that, as time passes, the burden of such examinations on the taxpayer increases. Memories fade; records may be lost or mislaid; to conserve space, honest taxpayers may well destroy records relating to years as to which the statute of limitations has run, especially where an audit has been held; and finally, those who have prepared the returns or assisted in their preparation may have died, moved away, or for one reason or another, be no longer available.

The opinion in **O'Connor** states the rationale of this line of cases (253 F. 2d at pp. 369-370).

> "We may well assume that considerations such as these had weight with Congress when it legislated in § 7605(b) to curb excessive administration zeal by protecting taxpayers from unnecessary examination and investigation. But if these considerations are to be

adequately served we cannot adopt the Government's contention that to obtain an order for enforcement as to a 'closed' year all that the Secretary or his delegate needs to show is the honesty of his subjective belief that fraud existed in such a year. The reason for this is that in the Government's view the necessity for an examination into a closed year would for all practical purposes be left to administrative determination and § 7605(b) would be relegated to hardly more than a pious exhortation directed to the tax authorities. As a practical matter, according to the Government's contention, the court's function under § 7604 would be reduced to little more than that of summarily affixing its stamp of approval to administrative action * * *

"To make the Congressional purpose expressed in § 7605(b) to protect taxpayers from unnecessary examinations truly effective we think the Secretary or his delegate, when a court order is needed to enforce compliance with a summons to testify as to a 'closed' year, should be required to establish to the court's satisfaction that there is probable cause for an investigation into such a year. We think Congress intended to give taxpayers this much protection when the investigation of their returns may reach far back into the past, * * * and that to require such a showing does not impose too heavy a burden upon the tax authorities or unduly restrict or hamper them in tax enforcement."

A year and a half later, in **Lash v. Nighosian**, 273 F. 2d 185 (C. A. 1, 1959), *certiorari denied*, 362 U. S. 904, another Internal Revenue Service summons directed to a taxpayer was challenged before the First Circuit Court of Appeals. The court reaffirmed its earlier holding in **O'Connor v. O'Connell**, and faced the narrower issue which had been raised in the district court as to "* * * the nature and

extent of the burden resting on the petitioner [IRS] to show probable cause or reasonable ground for suspicion of the existence of fraud.'' 273 F. 2d at p. 189. The court held (273 F. 2d at p. 189):

> ''* * * The function of the district courts in these cases as we see it is comparable to the function of a grand jury. It is to prevent the Secretary or his delegate from going on a 'fishing expedition' into a taxpayer's books or records for closed years, or from acting upon a mere hunch or a vague surmise, but to permit inspection as to closed years when the court is satisfied, meaning persuaded or content, that the official who issued the summons had a reasonable basis for his belief that the taxpayer had been guilty of fraud in a closed year. * * *''

The decision by the Court of Appeals for the Ninth Circuit in **DeMasters v. Arend**, 313 F. 2d 79 (1963) falls into this same category. The court there formulated new terminology in lieu of the phrases ''probable cause'' and ''reasonable ground for suspicion of fraud''; i.e., ''if it appeared that the decision [of the Commissioner] to investigate in aid of that purpose [to ascertain whether fraud is present] was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation would not be an 'unnecessary' one prohibited by Section 7605(b) * * *''.

In the **DeMasters** case, the Internal Revenue agent had begun his investigations in 1957, several years prior to issuance of the summons; had prepared net worth computations from various extrinsic sources, and had examined the records of a branch of the First National Bank of Portland. 313 F. 2d at p. 83. All this took place before the agent had a summons issued against the main office of the First National Bank of Portland. 313 F. 2d at p. 84. When this summons was challenged in a suit to enjoin enforcement, the agent testified at length as to his

net worth computations and his analysis of the taxpayers' bank deposits at the First National branch during one of the closed years. 313 F. 2d at p. 84.

It was in the context of this type and quantity of proof that the Ninth Circuit Court of Appeals articulated its "rational judgment" yardstick. The contrast with the proof, or rather with the total lack of proof, in the instant case, is obvious. The decision of the court below here expressly adopts the reasoning of the First and Ninth Circuits in the cases cited above (R. 52-53) and recognizes the test as being that "* * * which might cause a reasonable man to suspect that there has been fraud * * *" (R. 51).[12]

Thus, the Courts of Appeals for three Circuits—the First, Third and Ninth—expressly require a showing of probable cause, or an equivalent level of proof, as a necessary condition to enforcement of an Internal Revenue Service summons which seeks access to books and records for closed years; and the Courts of Appeals for two other Circuits—the Fourth and Seventh—having expressly found such proof to have been adduced in such cases did not find it necessary to pass upon the validity of the extreme proposition of law presented by the Government.

Cases from three other Circuits—the Second, Fifth and Sixth—give rise to the third category of cases; the category of cases on which the Government principally relies here (Br., pp. 8-9). Upon careful analysis, however, these are all cases in which, while their language indicates a broad view of the Internal Revenue Service's power, enforcement of the Service's summons was actually granted on the basis of records containing a factual showing, not on the basis of a bare allegation such as that here offered

12. An earlier case in the Third Circuit applied the "probable cause" test. **Zimmerman v. Wilson**, 105 F. 2d 583 (C. A. 3, 1939). In that case, the district judge had conducted a hearing at which extensive evidence pertaining to certain stock transactions between the taxpayer and his wife in which large losses had been taken. The district judge concluded that the Government's evidence established probable cause and his appraisal was accepted by the Court of Appeals.

by the Government. **United States v. Ryan**, *supra*, is such a case. While the court's opinion there contains broad language as to the nature of Internal Revenue Service's power to investigate, the opinion was rendered on the basis of a record which plainly showed that, in the district court, factual support had been adduced to support the application for enforcement of the summons.

In the **Ryan** case, the Revenue Agent testified at length in the trial court as to his investigation of the taxpayer's records for later tax years, his net worth computations as to those years, and the deficiencies he had determined. The books and records for closed years were demanded for the purpose of determining not only the correctness of returns for those years but also returns for later years as to which assessment and collection was apparently not time-barred. The Court of Appeals for the Sixth Circuit specifically stated in **Ryan**: "We think the District Court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary." 320 F. 2d at p. 502.

Obviously, the **Ryan** case does not stand for the proposition asserted by the Government in its brief (Br., p. 8), namely, that the Sixth Circuit is "* * * satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry".

A second case in this line is **Foster v. United States**, 265 F. 2d 183 (C. A. 2, 1959). There, the taxpayer under investigation was a non-resident citizen of the United States whose income had been derived from his own individually owned businesses abroad. Two affidavits were filed by the Special Agent in support of an administrative summons addressed to a bank, one of which was said in the opinion not to be essential to the court's decision (265 F. 2d at p. 186). The other affidavit described the taxpayer and his non-resident citizen status, the companies

from which he derived the money in question, his individual ownership of the companies, and so forth. The affidavit concluded that the books and records were needed "• • • to authenticate the exclusion of income claimed • • • to have been received as salary • • •" and to determine "• • • whether the income received • • • actually represents salary or the distribution of profits • • •", 265 F. 2d at p. 186.

On the basis of that affidavit, the Second Circuit Court of Appeals said (265 F. 2d, p. 186):

> "The simple uncontroverted allegations of fact in the agent's affidavit, as summarized in the foregoing text of this opinion, were enough, we hold, to support the [enforcement] order below." [13]

In other words, the question squarely considered was one of quantum of proof and burden of going forward.[14] The showing in **Foster** might well rise to the level of probable cause or reasonable ground to suspect fraud as required by the five Circuits already discussed, including the court below, but certainly this case does not support the Government's position in its brief (Br., p. 8) that the Second Circuit is "• • • satisfied when it is shown that the examination sought may be relevant and material

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13. In his opinion in the instant case, Judge Hastie remarked (R. 51):

> "If facts are alleged in the petition or in a supporting affidavit as the basis of the agent's suspicion and are not denied in a responsive pleading there may be no need to take testimony. Otherwise, the agent must present evidence showing some rational basis for his suspicion."

14. Judge Hastie also noted (R. 53):

> "Probably the Sixth and Ninth Circuits would sustain administrative judgment as to the need for reexamination of records of closed years upon a less impressive showing of suspicious circumstances than the First Circuit would require. However, this is a matter of quantum of proof which does not concern us here because no showing whatever has been made as to the basis of the special agent's suspicion."

to any of the purposes for which the Commissioner is authorized to make inquiry * * *".

Furthermore, to the extent that **Foster** might be said to have loosened the restraints on enforcement of an Internal Revenue Service summons in the Second Circuit, the loosening has since been limited to inquiries directed against third parties, that is, individuals such as banks or accountants who are in possession of a taxpayer's books and records, but are not themselves the taxpayer. **Application of Magnus**, 299 F. 2d 335 (C. A. 2, 1962), *certiorari den.*, 370 U. S. 918. In **Magnus**, one Internal Revenue Service summons had been served on a corporation in which one of the taxpayers under investigation was President, director and shareholder, and another summons had been directed to the accountants who prepared the tax returns for the taxpayers and their corporation. The court of appeals sustained the denial of the taxpayers' motion to quash the summons on several grounds, including the ground that the protection of Section 7605(b) against "unnecessary" examination extended only to the taxpayer, and that the taxpayers lacked standing to assert the claim where the books and records of a third party were involved.[15] The court of appeals expressly based its holding on the fact that a taxpayer was not involved, saying that third parties have only the protection accorded by the courts against burdensome or irrelevant subpoenas, but that "* * * as to taxpayers, nothing said so far prevents them from enjoying the benefits of this Section [Section 7605]." 299 F. 2d at p. 337. Thus, it can be said that, while the view of the Second Circuit Court of Appeals is not entirely clear, the Circuit clearly does not follow the principle attributed to it by the Government in its brief.

Finally, the decision of the Court of Appeals for the Fifth Circuit in **Globe Construction Co. v. Humphrey**, 229

15. This aspect of the holding of the Second Circuit Court of Appeals in **Magnus** appears to be in conflict with the decision of this Court in **Reisman v. Caplin**, *supra*.

F. 2d 148 (C. A. 5, 1956) falls into this category; yet it is one of the cases on which the Government here relies. The opinion in **Globe Construction Company** consists of three short paragraphs, the court's view being stated in a single one of them. The Government contended that the "• • • allegations in the affidavit of the officer who issued the subpoena were sufficient to support its issuance • • •". 229 F. 2d at p. 148. The court said: "We agree. Indeed we think: that the insistence of the appellant to the contrary proceeds from a misconception of the nature of the subpoena power at issue here and of the conditions requisite to its exercise." *Ibid.*

This cryptic opinion does no more than hint at the nature of the showing in the case. However, reference to the official court files in the case reveals that the Government agents filed two affidavits in the case, clearly revealing to the court and the taxpayer the basis for the Internal Revenue Service's belief that fraudulent returns might have been filed.

The first affidavit stated that the Special Agent's investigation of the company for the fiscal years 1951, 1952 and 1953 (apparently years as to which the time bar of the statute of limitations had not yet run) revealed certain practices by the company which warranted the imposition of substantial additional tax liabilities for these years, and that there was reasonable ground for believing that the same practices had been followed in the fiscal year 1950, the year as to which records were being sought, and which was a closed year. The second affidavit was filed a month later and made specific the allegations of the first affidavit. It was to the effect that the particular practices involved in all four returns (1951, 1952, 1953 and the year in question—1950) consisted of showing false and fraudulent allocations of construction costs in contracts between the Globe Construction Company, Inc., and the partnership of Christopher and Schlesinger; that the partnership was composed of Christopher, the President of Globe Construction

Company, and Schlesinger, the Secretary of that company; and that these false allocations between the construction company and the partnership resulted in false and fraudulent income tax returns being filed by Globe Construction Company and false and fraudulent partnership income tax returns being filed by Christopher and Schlesinger.

Obviously, this case does not stand for the proposition that the Fifth Circuit Court of Appeals is "* * * satisfied when it is shown that the examination sought may be relevant and material to any of the purposes for which the Commissioner is authorized to make inquiry * * *" (Gov't Br., p. 8). The allegations of the affidavits gave the exact items in specific income tax returns which were involved, and stated the precise basis for the Internal Revenue Service belief that the returns contained fraudulent entries. In other words, in the **Globe Construction Company** case, the cryptic language of the opinion, read in the light of the content of the affidavits, gives no support whatever to the Government in this case. The court there, as in every case where enforcement has been granted, had the benefit of a factual demonstration of the propriety of the investigation and examination.

The plain fact of the matter is that none of the eight Courts of Appeals which has addressed itself to this matter has rendered a decision which, upon careful analysis, even remotely supports the proposition that enforcement of an Internal Revenue Service summons would be granted on the basis urged in this case.

E. Legislative History.

Continuing on the assumption that Section 7605(b), taken alone, is here critical, the Government sets forth excerpts from the legislative history of that section intended to show that its major purpose was to prohibit harassing reexamination of taxpayers' books and records by overzealous agents.

We do not perceive that this contention, or the legislative history excerpts from which it derives, further the Government's case here. The avoidance of harassment was a purpose of the section, but the excerpts quoted by the Government also indicate full awareness on the part of Congress that there were other relevant sections of the Code and other obligations imposed on the Service. Thus, Congressman Hawley said (Gov't. Br., p. 17):

> "• • • It ought to be settled once for all when a man pays his tax, unless there should be good cause for a reexamination • • •."

Congressman Hawley's remark is entirely apposite to the circumstances of this case. Here, the return has been filed, the tax paid, a reexamination made and additional deficiency assessments paid. As the Congressman noted, the matter "• • • ought to be settled once for all • • •" unless the Service has "• • • good cause • • •" for further investigation. The Government is undoubtedly of the view that "• • • good cause • • •" need exist only in the mind of the Commissioner. However, it is clear that, in light of all of the relevant sections of the Code, the existence of good cause here, reason to suspect the existence of fraud, must be demonstrated to the court whose enforcement powers are invoked.

In fact, the most forceful indication of the meaning of these sections of the Code, as a matter of legislative history, is furnished by applying the principle that Congress, reenacting the precise language of a statute after the courts have construed it, will be presumed to have accepted the meaning thus attributed to the statute. **Shapiro v. United States**, 335 U. S. 1, 16 (1948); **Missouri v. Ross**, 299 U. S. 72, 75 (1936).

In the earliest case which addressed itself to the statutory question here involved, **In re Andrews' Tax Liability**, 18 F. Supp. 804 (D. Md., 1937), the District Court for the District of Maryland enforced an Internal Revenue Service

summons as to certain tax years, because, in the district judge's words, "* * * the Government has shown what may be fairly stated to be reasonable grounds of suspicion or probable cause for the examination to ascertain if there has been fraud". 18 F. Supp. at p. 807. By the same token, the district judge there denied enforcement of the summons as to another tax year, saying, "But no reasonable ground of suspicion of fraud or probable cause with regard thereto has been shown by the Commissioner which would justify enforcement of examination of the taxpayer's books for 1931, as to which one examination has already been made without disclosing the existence of any fraud; and another further examination at this time of the taxpayer's books and records for that year would seem to be unreasonable. * * *" 18 F. Supp. at p. 807.

There was an entire re-enactment, including the statutory language here involved, of the Internal Revenue Code in 1939. In that same year, the Court of Appeals for the Third Circuit, in **Zimmerman v. Wilson,** 105 F. 2d 583 (C. A. 3, 1939), adopted the reasoning of the **Andrews'** opinion quoted above and sustained enforcement of a summons because probable cause had been shown.

In 1941, the District Court for the Southern District of New York denied enforcement of an Internal Revenue Service summons in **In re Brooklyn Pawnbrokers** (1941) on the ground that the mere conclusory allegation in the affidavit of the agent that "* * * the taxpayer willfully and fraudulently understated his gross income for the years involved * * *" was not a sufficient showing. See, also, the opinion in **Martin v. Chandis Securities Co.,** 128 F. 2d 731, 735 (C. A. 9, 1942) where the court noted that the Service accepted the statutory obligation of showing probable cause.

The Internal Revenue laws were again codified and re-enacted in 1954. And, as we have shown, Sections 7402(b) and 7604(a) of the 1954 Code are re-enactments, with very slight modification, of Section 3633 of the 1939 Code.

In other words, as this Court stated in **Missouri v. Ross**, 299 U. S. at p. 75,

> "* * * Congress in the face of these decisions has permitted the [language] as it now appears * * * to stand for many years without change in its phraseology, although amending that portion of the [Internal Revenue] Act in other particulars. This is persuasive evidence of the adoption by that body of the judicial construction. [Cit.]"

Again, in **Shapiro v. United States**, 335 U. S. at p. 16, the Court said,

> "* * * there is a presumption that Congress, in re-enacting the * * * provision of the * * * Act, was aware of the settled judicial construction of the statutory [language]. In adopting the language used in the earlier act, Congress 'must be considered to have adopted also the construction given by this Court to such language, and made it a part of the enactment.'"

Thus, it is plain, we submit, that both as a matter of original intention in enacting this statutory language, and intention in re-enacting the identical language in the light of existing judicial construction, Congress intended that the Internal Revenue Service be required to show facts "* * * which might cause a reasonable man to suspect that there has been fraud * * *" as a condition precedent to enforcement of a summons such as that here involved. The decision of the court below complies precisely with this intent.

F. The Government's Alternative Argument.

As we noted in the introductory portion of this argument, *supra*, p. 13, the Government—as an alternative to its major contention that it may obtain judicial enforcement of an Internal Revenue summons on the basis of an administrative certification that the inquiry is not unneces-

sary—argues that the general statement of suspicion of fraud contained in the Special Agent's affidavit was a sufficient showing to justify enforcement. The affidavit is described as having "amply demonstrated to the Court that the Regional Commissioner's decision to authorize the reexamination was justified • • •" (Gov't. Br., p. 21).

This question as to the sufficiency of Tiberino's affidavit was not presented by the petition for certiorari and, accordingly, is not available to the Government for presentation. Rule 40(d)(2).

In any event, the argument is without merit. As we have already shown, the order entered by the district judge in this case, directing a one hour examination on condition that the Agent behave courteously, was clearly an attempt to compromise the dispute and avoid any sharp resolution of the question at issue. *Supra*, p. 6. Judge Hastie's opinion, in the court below, considered the Special Agent's general statement of suspicion as no showing at all. He did not consider that the agent had made any disclosure as to those facts which might have created suspicion in his mind (R. 51-52).

The view taken of this Special Agent's affidavit in the court below fully accords with those decisions which have considered the sufficiency of similar general statements of suspicion. See, *e.g.*, **In re Brooklyn Pawnbrokers, Inc.**, 39 F. Supp. 304 (E. D. N. Y., 1941); **United States v. Carey**, 63-1 USTC ¶ 9495 (D. Del., 1963). And, in **McDermott v. John Baumgarth Company**, 286 F. 2d 864 (C. A. 7, 1961), where the Service's petition to enforce had, as an attachment, an affidavit of an Agent containing a general statement almost identical with that here involved—if anything, more specific—the Service produced the Agent as a witness and he, in turn, furnished substantial detailed testimony in support of his general statement. 286 F. 2d at p. 865. Nevertheless, the Government here contends that the Agent's general statement indicated sufficient knowledge on the part of the Service so that the Service "• • • would

have been remiss if it had not pursued its investigation. * * *" (Br., p. 21).

The worth of this contention, and the risk involved if it were to be accepted, is illustrated by reference to a related case, involving a different corporate taxpayer, **United States and Tiberino v. Max Powell,** Misc. No. 2573, E. D. Pa.[16] In origin, this case was, in all respects, identical with the instant case. The same form of petition for enforcement was filed, to which was attached an affidavit by the same Special Agent containing the identical general statement of suspicion of fraud. After the decision of the court below in this case, and certain other proceedings not here material, the Service elected to attempt to substantiate the allegation of fraud in the affidavit by producing, first, additional affidavits, and, second, live testimony by the investigating Agent. After several hearings, submission of briefs and presentation of oral argument, the District Judge, the Honorable Francis L. Van Dusen, concluded that the Service had failed to establish facts and circumstances on which a reasonable man would suspect the existenc eof fraud. Judge Van Dusen's final opinion and order were filed on June 5, 1964. An appeal has been noted by the Government.

As we said above, the proceeding before Judge Van Dusen illustrates the danger, a danger which has always been recognized by the courts, of accepting a general statement of suspicion of fraud as a basis for an order of enforcement. Called upon to substantiate the general charge, the Government has been unable to establish any satisfactory factual basis for its suspicion. Yet, here, the Government argues that the general statement itself should be considered by this Court as a sufficient factual showing.

16. The instant case involves Wm. Penn Laundry, one of a number of corporations formerly owned and controlled by Mr. Lawrence C. Kline. The above cited case, Misc. No. 2573, involves another of Mr. Kline's holdings, Kline's Coat, Apron & Towel Service of Harrisburg.

In essence, the Government's second argument is to the same effect as its principal argument, namely, that no real showing need be made at all. The ultimate thrust of either argument is to reduce the role of the court to that "* * * of summarily affixing its stamp of approval to administrative actions * * *". **O'Connor v. O'Connell**, 253 F. 2d 365, 370 (C. A. 1, 1958); **Lash v. Nighosian**, 273 F. 2d 185, 189 (C. A. 1, 1959), *certiorari den.*, 362 U. S. 904.

We submit that, even if the Internal Revenue Service need not make a preliminary showing when the years at issue are not time-barred (and that issue is not presented in this case), the running of the statute of limitations automatically calls into question the purpose for which the Internal Revenue Service has undertaken an investigation, and thereby calls for some preliminary level of showing that the purpose is proper. None of the Courts of Appeals has permitted itself to become a rubber stamp in the enforcement of Internal Revenue Service summonses; the statutory language does not permit, and certainly does not compel, such a result; and the Internal Revenue Service has advertently, in the light of the many decisions of the federal courts, avoided seeking from Congress the power which, in this Court, it now asserts it already possesses.

CONCLUSION.

For the reasons set forth above, we respectfully submit that the judgment of the court below should be affirmed.

Respectfully submitted,

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September 25, 1964

INDEX

CITATIONS

Statute:

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 54

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR., SPECIAL AGENT, INTERNAL REVENUE SERVICE, PETITIONERS

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

The government's principal argument is set forth in full in its opening brief. This reply brief will be devoted to answering points raised by respondents which either misconstrue or challenge the government's position.

1. In our original brief (p. 11) we pointed out that, while the substance of the complaint in the district court was to obtain enforcement of a summons—which is provided for in Sections 7402(b) and 7604(a) of the Internal Revenue Code of 1954—the complaint mentioned Section 7604(b), which provides for the attachment and arrest of a person who has been

served with a summons and has "wholly made default or contumaciously refused to comply." See *Reisman* v. *Caplin*, 375 U.S. 440, 448–449. There can be no doubt that this label was a mistake since the government neither in the complaint nor at the hearing sought attachment or arrest of respondent Powell. Consequently, the brief stated that the case should be considered under Sections 7402(b) and 7604(a), instead of Section 7604(b) as the court of appeals (which was misled by the government) had done. Respondents have answered (Br. 19–20) that the government cannot belatedly change its theory of the case in order to obtain an advantage.

Respondents, however, misconstrue the government's position. We do not argue that a lesser standard is required for enforcement under Sections 7402(b) and 7604(a) as compared to Section 7604(b). On the contrary, we submit that whatever the method employed by the Commission in initiating enforcement proceedings, no showing of probable cause is required. To be sure, as this Court made clear in *Reisman* v. *Caplin*, *supra*, the person summoned is entitled to a hearing at the judicial proceeding whichever enforcement procedures are utilized by the Commissioner. *Id.* at 449. At such a hearing, the witness may challenge the summons on any ground, including the one urged here by the respondents—that the investigation is "unnecessary" within the meaning of Section 7605(b).

2. The government noted (Br. 12–13) that the decisions of this Court in *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 209, and *United States* v.

Morton Salt Co., 338 U.S. 632, 652, have laid to rest the notion that an administrative agency, as a constitutional prerequisite to enforcement of its investigative power, was required to show "probable cause" that the law was being violated. See also *Civil Aeronautics Board* v. *Hermann*, 353 U.S. 322. These cases also established the general rule that where, as here (see Sections 7601, 7602), an agency has been granted broad powers of investigation, the governing criteria for enforcement of an administrative summons is whether the information sought is relevant to a statutory purpose. However, we do not argue, as respondents claim (Br. 24), that these cases, without more, preclude judicial inquiry into the question of whether the Commissioner's power to investigate is subject to a showing of probable cause. If Congress had made clear that, despite its broad initial grant of power to the Commissioner, it was limiting this power in one or more respects more narrowly than was usual for administrative investigations, we, of course, would recognize that this limitation would be controlling. Therefore, the question in this case is, as we emphasized in our original brief, whether Congress imposed a requirement of probable cause by the prohibition in 7605(b) against "unnecessary" examinations. Our position is that this section contains no such standard, and that consequently only the general rule of relevancy and materiality, which was announced in *Oklahoma Press* and *Morton Salt* and as reflected in the language of Section 7602 itself, is applicable.

3. In summarizing the holdings of the various courts of appeals in our original brief, we stated (Br. 8) that the probable cause standard—followed by the First Circuit and by the court below—has been expressly rejected by the Second, Fifth, Sixth, and Ninth Circuits. Respondents claim (Br. 27–36), however, that none of the decisions cited by the government establishes that those circuits would approve enforcement of a summons on the basis of the factual allegations made in this case. Thus, respondents have apparently adopted the view of the court below that the difference among the circuits is not one of principle, but is merely "a matter of quantum of proof" (R. 53).

The basic premise of the decisions in the First and Third Circuits is that the factual showing made by the government must establish that there is probable cause to believe the existence of fraud. In contrast, the Second Circuit has held that "an affirmative showing of probable cause for the administrative inquiry is not required. * * * [T]he Commissioner, as a condition to the issuance of a summons and order under Sections 7602 and 7604, should not be required to prove grounds for belief that [because of fraud] the liability was not time-barred 'prior to examination of the only records which provide the ultimate proof.'" *Foster* v. *United States*, 265 F. 2d 183, 186–187, certiorari denied, 360 U.S. 912. Respondents suggest (Br. 34) that the holding in *Foster* has been limited to situations where the summons is directed to a third party and not to the taxpayer. Their

argument is based on the Second Circuit's decision in *Application of Magnus*, 299 F. 2d 335, certiorari denied, 370 U.S. 918, which holds that Section 7605(b) protects only taxpayers themselves. But *Foster*, while including a third party, is specifically not based on this ground (265 F. 2d at 188); instead, it holds that no showing of probable cause is necessary when a summons is directed to a taxpayer, where Section 7605(b) in terms applies, just as when it is directed to a third party.

The Sixth Circuit has likewise stated that "Congress [has not] required the Secretary to establish, as a condition precedent to the exercise of his right to investigate, that he have a reasonable basis therefor or probable cause to suspect criminality." *United States* v. *Ryan*, 320 F. 2d 500, 502, pending on writ of certiorari, No. 12, this Term. See also *Peoples Deposit Bank & Trust Co.* v. *United States*, 212 F. 2d 86 (C.A. 6). The Fifth Circuit, while not stating the correct standard, has rejected the argument that the government must show probable cause on the ground that it "proceeds from a misconception of the nature of the subpoena power at issue here and of the conditions requisite to its exercise." *Globe Construction Co.* v. *Humphrey*, 229 F. 2d 148. And the Ninth Circuit, although requiring the government to show that it made a "rational judgment based on the circumstances of the particular case," held that "the power of inquiry vested in the Commissioner * * * does not depend upon a showing of probable cause to believe that a violation of law

has occurred." *De Masters* v. *Arend*, 313 F. 2d 79, 88, petition for certiorari dismissed, 375 U.S. 936.

Respondents attempt to explain those cases on the basis that the government introduced sufficient evidence to constitute probable cause. But even if respondents were correct in their analysis of the evidence in those cases, their attempted explanations of the reasons for the decisions are not a substitute for what the courts of appeals in fact held. The above decisions, in short, stand for the proposition that the government need not have offered evidence constituting probable cause, whether or not it did so.

Moreover, we submit that, contrary to respondents' interpretation, the factual allegations presented to the Second, Fifth, and Sixth Circuits were no stronger than those presented here. In *Foster*, as the court below apparently recognized (R. 51), the agent's affidavit did not even state (unlike the affidavit in the present case) that he had "reason to suspect" tax evasion for the closed years. The affidavit in *Foster* stated only that the records sought were "required to authenticate" whether the taxpayer had properly excluded certain income as salary instead of including it as a distribution of corporate profits, 265 F. 2d at 186. In *Globe Construction*, the only specific factual allegation contained in the agent's affidavit was that there were reasonable grounds to believe that the company had fraudulently understated its income by "showing false and fraudulent allocations of construction costs in contracts of construction between the Globe Construction Company, Inc. and the partner-

ship of Christopher and Schlesinger * * *." See Record in Court of Appeals, No. 15,669, p. 17. In *Ryan*, no affidavit was submitted by the agent, and the petition to enforce the summons simply alleged that a net worth estimate of the defendant's assets for the years 1942 through 1953 created reasonable grounds to suspect fraud. While the agent in *Ryan* personally testified,[1] his testimony was only that the determination as to the possibility of fraud was based upon his tentative net worth computation and upon certain unspecified government documents and third party information. Record in No. 12, this term, p. 25. The district court held that the agent was not required to produce the net worth computation for examination by defense counsel (*ibid.*), and no other testimony was adduced to show the factual basis for the agent's conclusion of possible fraud.

4. To support their contention based on legislative history,[2] respondents argue (Br. 37–39) that, since the enactment of Section 7605(b) into law in 1921, the entire Revenue Code has been reenacted in 1939 and 1954; that, prior to each reenactment, there were judicial decisions which held that probable cause to believe fraud had been committed must be shown before the court will order enforcement of a summons relating to closed tax years; and that "the most forceful indication of the meaning of * * * the Code * * * is furnished by applying the principle that Congress,

[1] No testimony was offered by the government in either *Foster* or *Globe Construction*.

[2] The legislative history of Section 7605(b) is discussed in the government's original brief at pp. 17–19.

reenacting the precise language of a statute after the courts have construed it, will be presumed to have accepted the meaning thus attributed to the statute."

Both cases on which respondents rely—*Missouri* v. *Ross*, 299 U.S. 72, and *Shapiro* v. *United States*, 335 U.S. 1—hold that Congress is considered to have adopted the judicial construction of a statute when the construction is by this Court—a decision of which Congress is almost certain to be aware and to consider as authoritative. Here, in contrast, this Court has never been called upon to construe Section 7605(b). Moreover, even if lower court decisions might, in some circumstances, suffice, the four cases cited by respondents in their brief hardly constitute a "settled judicial construction" of the statute. In *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731 (C.A. 9), the government did not controvert the taxpayer's allegation that a showing of probable cause to suspect fraud was required, and the court therefore "accept[ed] it as the test * * * without expressing any opinion as to the soundness thereof." *Id.* at 735. The decision *In re Andrews' Tax Liability*, 18 F. Supp. 804 (D. Md.), did not even purport to interpret Section 7605(b), but held that the Fourth Amendment precluded the Commissioner from examining the taxpayer's books unless there was probable cause to suspect fraud. The rationale of the *Andrews* decision was thereafter expressly followed in *Zimmerman* v. *Wilson*, 105 F. 2d 583, 586 (C.A. 3), and *In re Brook-*

lyn Pawnbrokers, Inc., 39 F. Supp. 304 (E.D. N.Y.)[3] These cases, which rest upon an erroneous interpretation of the Fourth Amendment (see *Oklahoma Press Publishing Co.* v. *Walling, supra,* and *United States* v. *Morton Salt Co., supra*), are directly inconsistent with *In re Keegan,* 18 F. Supp. 746 (S.D. N.Y.), which held that the government could even conduct a "fishing expedition." Moreover, there is no indication that any of these cases were ever considered by or even called to the attention of Congress when it included what is now Section 7605(b) as one of thousands of sections in the comprehensive 1939 and 1954 revenue statutes. In these circumstances, it is hardly realistic to say that Congress intended to reenact in Section 7605(b) respondent's view of the statute.

5. Respondent argues (Br. 42) that the "ultimate thrust [of the Government's position] is to reduce the role of the court to that" of "a rubber stamp in the enforcement of Internal Revenue summonses." The statement that the Goverment's contention would lead to such a result stems from a misapprehension of our position. When the government applies for enforcement of a summons, "the witness may challenge the summons on any appropriate ground." *Reisman* v. *Caplin, supra,* 375 U.S. at 449.[4] The application may appropriately be resisted on the ground that enforce-

[3] While *Brooklyn Pawnbrokers* held that the government must make more than a conclusory allegation of suspicion of fraud, it did not actually hold that probable cause must be shown.

[4] There is no indication in *Reisman* v. *Caplin* that one "appropriate ground" is that the Commission has failed to show probable cause.

ment of the summons would violate the constitutional rights of the witness, such as compelling him to incriminate himself or subjecting him to an unreasonable search and seizure (*Bouschor* v. *United States*, 316 F. 2d 451, 457–459 (C.A. 8); *In re Turner*, 309 F. 2d 69 (C.A. 2); *Hubner* v. *Tucker*, 245 F. 2d 35 (C.A. 9)); or that the material is protected by the attorney-client privilege (*Sale* v. *United States*, 228 F. 2d 682 (C.A. 8), certiorari denied, 350 U.S. 1006); or that the summons was issued for the improper purpose of obtaining evidence for use in a criminal prosecution (*Boren* v. *Tucker*, 239 F. 2d 767, 772–773 (C.A. 9)); or that the investigation is not of the kind authorized by statute (*Pacific Mills* v. *Kenefick*, 99 F. 2d 188 (C.A. 1)); or that the demand made is too broad in scope or the material sought is not "relevant or material" (Section 7602) to a lawful subject of inquiry (*Oklahoma Press Publishing Co.* v. *Walling*, *supra*, 327 U.S. at 217, note 57). As this Court held in *Oklahoma Press* in rejecting a similar contention, such matters "are neither minor nor ministerial" and the judicial function is neither "abused or abased * * * by leaving to it the determination of the important questions which the Administrator's position concedes the courts may decide." *Id.* at 216–217. In short, there is ample scope in the judicial enforcement proceeding for protection against arbitrary use of the Commissioner's power to issue summonses.

6. Finally, respondents assert (Br. 39–40) that by failing to raise the point in its petition for certiorari, the government is precluded from making the argument that, even if some showing were needed to

justify enforcement of the summons, the agent's affidavit plainly demonstrated the necessity and reasonableness of the instant investigation (Gov. Br. 21) Rule 40(d)(2) of this Court simply requires that the brief on the merits "may not raise additional questions or change the substance of the questions" presented in the petition for certiorari. Here, the question presented in our brief on the merits—whether the government must show probable cause—is identical to the question set forth in our petition for certiorari. Under this question, we argued in our petition, as in our brief on the merits, that, as long as the inquiry is "relevant and material," the government need make no showing as to its suspicion of fraud and, alternatively, that the showing in the affidavit was sufficient. Plainly, the government is not raising a new issue contrary to the Rules.

CONCLUSION

For the foregoing reasons and those stated in the government's opening brief, we respectfully submit that the judgment below should be reversed.

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